

**INTERNAL REVENUE SERVICE**  
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM  
November 29, 2001

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CASE MIS No. : TAM-138876-01/CC:PSI:B05

Taxpayer's Name:

Taxpayer's Identification No:

Years Involved:

Date of Conference:

**LEGEND:**

Taxpayer	=
State A	=
Station	=
Project	=

**ISSUE:** Whether certain property is eligible for transitional regular percentage investment credit under former section 49 of the Internal Revenue Code and section 203(b)(1)(C) of the Tax Reform Act of 1986 (Act, or 1986 Act)?

**CONCLUSION:** The property does not qualify for transition relief and, accordingly, no credit may be claimed under the transition rules.

**FACTS:**

Taxpayer is a public utility subject to regulation by State A and the Federal Energy Regulatory Commission. Taxpayer is primarily engaged in the production, purchase, transmission, distribution, and sale of electricity.

Taxpayer has made an informal claim concerning the computation of its investment tax credit (ITC), relating to the tax years through .

All matters at issue relate to the participation of Taxpayer in the Project, a joint venture among several electric utilities. The sole activity of the Project was and is the construction and operation of a nuclear generating facility--Station. During the years at issue, Taxpayer was a percent participant in Station. Taxpayer was also the operator of the plant.

Station consists of separate "units," each with its own nuclear reactor, generators, and cooling equipment. Station was planned in the and the units came on line and began commercial operation as they were completed. The placed in service dates are:

Station also includes certain Common Facilities that serve all units.

Taxpayer's tax returns for the years during which Station was under construction, including the years that the units went into service, were examined by the Commissioner. Costs incurred in the construction of Station qualifying for ITC (including the initial nuclear fuel loads for were claimed by Taxpayer for ITC purposes on the returns as filed. as well as various common facilities qualified as transition property under section 203(b)(1)(C) of the 1986 Act, 1986-3 (Vol. 1) C.B. 83.

The units of the Station use nuclear fuel to operate the reactors. Nuclear fuel assemblies are specifically calibrated and assembled for the Station. Each reactor must have in place and loaded the requisite amount of nuclear fuel to begin operations. As is customary in the nuclear industry, the reactors are periodically shut down for refueling. During these planned shutdowns, a portion of the nuclear fuel is removed and replaced with new nuclear fuel.

Nuclear fuel assemblies are specifically designed equipment manufactured according to the unique and detailed specifications provided by the operator of the facility and are not interchangeable with the assemblies of other plants. The design of the fuel, including the selection of uranium enrichments, ensure that the assemblies meet both Nuclear Regulatory Commission (NRC) and reactor-specific license conditions.

Numerous steps are required in the process of providing finished initial core and reload fuel assemblies that are ready to be placed into the reactor. A long production lead time is required from when the uranium ore is mined until the finished fuel assemblies are placed in the reactor. By the time the assemblies reach the reactor, the

uranium fuel has been mined, chemically processed, isotopically enriched, and fabricated.

went into service in depreciation was begun on the nuclear fuel (as a separate asset; 5-year class life), and ITC was claimed and was allowed on audit by the Service for the initial loads at those units. No ITC has been claimed on the returns as filed for any nuclear fuel loads for any unit for any period except the initial loads at

Nuclear fuel assemblies is a specifically defined asset class for both the accelerated cost recovery system (ACRS) and modified accelerated cost recovery system (MACRS). It has an assigned class life under MACRS of 5 years (Rev. Proc. 87-56, 1987-2 C.B. 685, asset class 49.121).

Taxpayer has always shown nuclear fuel as a separate asset in both its book and tax records. Depreciation is begun on the asset at the time it is placed in service. Prior to , Taxpayer depreciated nuclear fuel over a 5-year period when using MACRS. In , Taxpayer changed its method for depreciating nuclear fuel to the "burn method" (percentage of asset used up).

Project entered into long-term contracts with various suppliers for the purchase and delivery of nuclear fuel assemblies. These voluminous contracts contain a variety of terms (obligations to purchase; obligation to sell; pricing determinants; escape clauses; engineering data; etc.) and a variety of delivery dates. The contracts are executed variously from , to . The contracts envision the providing of nuclear fuel and support services at various dates throughout the . One of the contracts mentions a delivery date of . The general thrust is to create a confirmed source for nuclear fuel for Taxpayer and to create a sure customer for the suppliers. The contracts leave most of the specific terms to be determined at later dates and/or to be determined by "market" numbers at the time of the expected future delivery. These are "binding contracts" within the meaning of section 203(b)(1)(A) of the 1986 Act.

There were specific plans in place as of , which planned for the inclusion of the nuclear fuel in all units of Station.

Additional ITC is claimed as a part of the informal claim for reloads of nuclear fuel in the amount of .

Additional ITC is claimed for certain equipment and replacements of equipment at the Station in the amount of . The equipment has been broken out into three categories by Taxpayer as Replacement Property, Required Machinery and Equipment, and Appurtenances.

The units at Station were placed in service for depreciation purposes in the following sequence: in in in in . Prior to the units being placed in service Operating Licenses were

issued on the following dates:

The purpose of the Operating License is to demonstrate that all required construction activities associated with the unit have been completed and the unit's construction permit has been superseded by the Operating License. This milestone also documents that the units are at a state when operational testing can begin. This testing sequence is part of the overall plan to license a nuclear generation unit for full power operation. As a prerequisite to this testing program a comprehensive summary of all known limiting conditions to operations are agreed to by the NRC and the utility. These conditions impose additional operational and administrative burdens on the utility and as part of the process a schedule is developed to remove these limiting conditions. These conditions become a part of the Final Safety Analysis Report (FSAR), a public record; the actions required to remove these conditions and the timetable for this to happen are also part of the FSAR.

The purpose of operational testing, in part, was to confirm that the various systems that make up a unit will function as designed over a prolonged period under both normal operating and transient conditions. This testing is in addition to the construction and pre-operational testing that was completed before the Operating License was issued. Based on the complexities associated with the systems involved Taxpayer's engineering staff had projected that testing would not be completely flawless and had prepared contingency plans to address any anticipated short comings.

Recognizing that a primary purpose of the testing program is to identify and correct design flaws and equipment deficiencies, including premature failures, contingency plans were developed. For those deficiencies that potentially could impact on the Units' Operating Licenses the following types of contingency plans were in place: first, immediately correct those deficiencies that would challenge the safe operation of the plant; second, evaluate those situations that might impact on meeting the unit's licensing requirements over time; third, determine which are equipment-based deficiencies, and schedule the necessary corrective actions as required in the future. Likewise, identify procedural inadequacies and correct those. Noting that the type 1 and type 2 deficiencies must be corrected or the unit would not remain in compliance with the unit's operating license, they are treated very seriously. The action necessary to correct these deficiencies and the proposed timetable becomes a binding commitment on the utility. Failure to comply can result in the unit being shut down by the NRC. As an example, the following deficiencies of this nature were discovered during the full power testing for the units at Station. During the start of there was a catastrophic failure of turbine blades (buckets) due to the presence of foreign material left during the construction phase. In this case the damaged parts were replaced and testing continued. During the start up of it was determined that the failure of one of the two fans in an equipment train resulted in a partial failure of the system. Each unit has four fans with two fans in a group. This grouping is labeled a train. To be considered fully operational all four fans must be able to function. To correct this, there was a design modification and back-draft dampers were installed in all units; a total of back-draft dampers were put in place.

The pre- construction plan for the facility focused on the major structural components of the nuclear generating units. Not specially shown in the construction plan is the incidental equipment necessary for the normal day to day operation of the plant, such as the tools and equipment necessary to complete a refuel outage. This is partly because this type of equipment is normally purchased separately. Likewise, the computer systems utilized in the day to day management of the plant by such groups as maintenance and radiation protection equipment are purchased separately so as to take advantage of the latest available technology. It is common practice in the industry that once the requirements to license the plant and bring it to operational status have been met, for the utility to complete these systems. This equipment is understood to be equipment that can be replaced seamlessly with a minimum disruption on the operation of the plant--meaning that personnel perform the function until the equipment is returned to service. As an example, surveillance cameras are used to monitor the fencing around the plant. If that system would fail, security guards would be detailed to physically perform surveillance.

The pre- construction plans identified most of the major appurtenances, including the auxiliary building and security access facilities. Certain final decisions, regarding these structures, were deliberately postponed. An example of this is the decision that was made after construction had begun to establish the controlled access to the units' radiological controlled area (RCA) on the -foot elevation of the auxiliary building. This decision required remodeling to accommodate that need. The RCA consists of the containment building, rad-waste building, and the auxiliary building. Although completely separate buildings, these structures share some common walls. While the physical footprint of the buildings did not change, an area approximately feet by feet was designated as auxiliary building space. The area previously was part of the control and rad-waste buildings. Based on the need to efficiently maintain the different security levels required for an operating nuclear plant as compared to a plant in the construction phase, the overall security plan of the facility was not put in effect until entered startup. Previous to this occurring, entry to the operations was controlled administratively with the plant security force performing the required security inspections and physically establishing an exclusion area to perform the required vehicle inspection. Similarly, annex buildings for each unit and a central maintenance shop were constructed after startup when it was determined that the maintenance facility could not be located outside the security controlled area as was originally planned.

As has been noted, also claimed under the "plant facility" argument and a subject of this technical advice request is of equipment placed in service at Station which was not nuclear fuel. All of these assets were placed in service in the Taxpayer's fixed asset system as assets separate from the Station itself.

Taxpayer divided this portion of the claim into three categories: 1) Replacement Property; 2) Machinery & Equipment; and 3) Appurtenances. Within each category, the assets were further subdivided by type, or by asset category code.

After Station was placed in service, deficiencies were identified through additional testing and the initial operation of the plant. These deficiencies (such as design flaws, equipment inefficiencies, etc.) caused concern about the reliability of equipment essential to the operation of the plant. As a result, the deficient equipment had to be reconstructed or modified to ensure the safe and efficient operation of Station. In other cases, it was determined that purchases of additional equipment were appropriate and useful to assure the operation of the facility in the manner which had been planned. The replacement property above was the equipment placed in service after Station began operations.

The largest cost in the replacement property category is the approximately \$ million for the replacement of the reactor coolant pump (RCP) shafts. The original RCP shafts were installed as integral components of Station during the initial base construction of the facility. Soon after Station came on line in reports came out of Europe that RCP shafts of similar design had exhibited cracking. Safety inspections revealed that the RCP shafts should be replaced. On , Station committed to the NRC to make the necessary modifications to the RCP shafts. The replacement shafts were placed in service in and .

The remaining property under the subgrouping is also replacement property. All of the original equipment which was replaced was included in the original plan of construction and was incorporated into the facility during base construction. However, during the testing and initial start-up phase, it was discovered that this equipment did not function as intended and needed to be replaced or modified. ITC was claimed and allowed for those original parts at the time Station, itself, was placed in service.

Subsequent to the successful completion of full power testing and the beginning commercial operation for each of the units at Station, the utility continued the installation of equipment and systems not directly required for the operation of the unit. This category of equipment was for the efficient operation of the plant.

The largest dollar amounts of property in this category are:

Computers--process computer equipment and workstations necessary for the efficient monitoring and management of the units;

Tools and Equipment--outage tooling, radiological monitoring equipment, laboratory and testing equipment, etc.; and

Other--general support computers, training equipment, and security monitors.

As in the case with the required machinery and equipment discussed above, Taxpayer also installed incidental machinery, equipment, and a structure adjacent to the facility after Station's initial start-up. There is some overlap between incidental equipment included in this category and the required machinery and equipment above, however. Appurtenances also include assets that are not directly incorporated into the facility. The majority of the cost included under this subheading consist of:

Other Economic Improvements--remodel of the auxiliary building--original plan required a -foot building which proved to be insufficient and an additional feet were added to all units. This auxiliary building contains the engineered safeguard system, various cooling water and ventilation systems, and the maintenance access control area;

Buildings & Property--construction of an annex building to house equipment for the facility. The construction of the , an isolated fence area to inspect vehicles prior to their entrance into the facility grounds; and

Tools & Equipment--these appurtenances were for the containment, storage and transfer of contaminated materials. Specifically, this property included a shield liner transfer system (to transfer radiated materials), radiation filter shields, a respirator cleansing facility, portable containment structures, etc.

#### LAW AND ANALYSIS:

Before the enactment of the 1986 Act, the Internal Revenue Code of 1954 provided that qualifying businesses were entitled to an investment credit for certain types of tangible personal property placed in service during the tax year. Section 46(a) of the 1954 Code provided that "the amount of the investment credit determined under this section for any taxable year shall be an amount equal to . . . the regular percentage" of a taxpayer's "qualified investment."

Former section 49(a) of the Code, added by section 211(a) of the 1986 Act, eliminated this credit by making the "regular percentage" specified in former section 46(a) inapplicable to "any property placed in service after December 31, 1985." Former section 49(b) provided that the repeal will not apply to transition property as defined in former section 49(e).

Former section 49(e)(1) of the Code defined the term "transition property" as any property placed in service after December 31, 1985, and to which the amendments made by section 201 of the Act do not apply, except that in making the determination-- (A) section 203(a)(1)(A) of the Act will be applied by substituting "1985" for "1986," (B) sections 203(b)(1) and 204(a)(3) of the Act will be applied by substituting "December 31, 1985" for "March 1, 1986," (C) in the case of transition property with a class life of less than 7 years--(i) section 203(b)(2) of the Act will apply, and (ii) in the case of property with a class life--of (I) less than 5 years, the applicable date will be July 1, 1986, and (II) at least 5 years, but less than 7 years, the applicable date will be January 1, 1987, and (D) section 203(b)(3) of the Act will be applied by substituting "1986" for "1987."

Substituting the applicable dates, section 203(b)(1)(C) of the Act provides that the amendments made by section 201 of the Act shall not apply to "an equipped building or plant facility if construction has commenced as of December 31, 1985, pursuant to a written specific plan and more than one-half of the cost of such equipped building or facility has been incurred or committed by such date."

Section 203(b)(4) of the Act provides that “for purposes of [section 203(b)(1) of the Act], the term “plant facility” means a facility which does not include any building (or with respect to which buildings constitute an insignificant portion) and which is--(A) a self-contained single operating unit or processing center, (B) located on a single site, and (C) identified as a single unitary project as of December 31, 1985.

The Conference Report , 2 H.R. Rep. No. 99-841 (Conf. Rep.), 99<sup>th</sup> Cong., 2d Sess. II-54, 1986-3 (Vol. 4) C.B. 54, provides *in toto* the following concerning the transition rule in section 203(b)(1)(C) of the Act:

***“Equipped buildings”***

Under the conference agreement, where construction of an equipped building began on or before March 1, 1986 (December 31, 1985, for purposes of the investment tax credit), pursuant to a written specific plan, and more than one-half the cost of the equipped building (including any machinery and equipment for it) was incurred or committed before March 2, 1986 (January 1, 1986, for the investment tax credit) the entire equipped building project and incidental appurtenances are excepted from the bill’s application.<sup>1</sup> Where the costs incurred or committed before March 2, 1986 (January 1, 1986, for the investment tax credit) do not equal more than half the cost of the equipped building, each item of machinery and equipment is treated separately for purposes of determining whether the item qualifies for transitional relief.

Under the equipped building rule, the conference agreement will not apply to equipment and machinery to be used in the completed building, and also incidental machinery, equipment, and structures adjacent to the building (referred to here as appurtenances) which are necessary to the planned use of the building, where the following conditions are met:

(1) The construction (or reconstruction or erection) or acquisition of the building, machinery, and equipment was pursuant to a specific written plan of a taxpayer in existence on March 1, 1986 (December 31, 1985, for the investment tax credit); and

(2) More than 50 percent of the adjusted basis of the building and the equipment and machinery to be used in it (as contemplated by the written plan) was attributable to property the cost of which was incurred or committed by March 1, 1986 (December 31, 1985, for the investment tax credit), and construction commenced on or before March 1, 1986 (December 31, 1985, for the investment tax credit).

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1. For example, if property with a class life of less than 7 years is incorporated into an equipped building, then such property would not independently need to satisfy this placed-in-service requirements. Instead, such property would qualify for transition relief as part of the equipped building—as long as the equipped building is placed in service by the prescribed date.

The written plan for an equipped building may be modified to a minor extent after March 1, 1986 (December 31, 1985, for the investment tax credit) and the property involved may still come under this rule; however, there cannot be substantial modification in the plan if the equipped building rule is to apply. The plan referred to must be a definite and specific plan of the taxpayer that is available in written form as evidence of the taxpayer's intentions.

The equipped building rule can be illustrated by an example where the taxpayer has a plan providing for the construction of a \$100,000 building with \$80,000 of machinery and equipment to be placed in the building and used for a specified manufacturing process. In addition, there may be other structures or equipment, here called appurtenances, which are incidental to the operations carried on in the building, that are not themselves located in the building. Assume that the incidental appurtenances have further costs of \$30,000. These appurtenances might include, for example, an adjacent railroad siding, a dynamo or water tower used in connection with the manufacturing process, or other incidental structures or machinery and equipment necessary to the planned use of the building. Of course, appurtenances, as used here, do not include a plant needed to supply materials to be processed or used in the building under construction. In this case, if construction of the building is under a binding contract and property but no equipment had been ordered, and the appurtenances had not been constructed or placed under binding order, the equipped building rule would apply. This is true because the building cost represents more than 50 percent of the total \$180,000. As a result, the machinery and equipment, even though not under binding contract, is eligible for the rule. In this connection, it should be noted that the additional cost of appurtenances, \$30,000, is not taken into account for purposes of determining whether the 50-percent test is met. Nevertheless, the bill would not apply to these appurtenances since the 50-percent test is met as to the equipped building.

### ***Plant facilities***

The conference agreement also provides a plant facility rule that is comparable to the equipped building rule (described above), for cases where the facility is not housed in a building. For purposes of this rule, the term 'plant facility' means a facility that does not include any building (or of which buildings constitute an insignificant portion), and that is a self-contained single operating unit or processing operation—located on a single site—identifiable as a single unitary project as of March 1, 1986.

If pursuant to a written specific plant of a taxpayer in existence as of March 1, 1986, (December 31, 1985, for the investment tax credit), the taxpayer constructed, reconstructed, or erected a plant facility, the construction, reconstruction, or erection commenced as of March 1, 1986 (December 31, 1985, for the investment tax credit), and the 50-percent test is met, then the conference agreement will not apply to property that makes up the facility. For this purpose, construction, etc., of a plant facility is not considered to have begun until it has commenced at the site of the plant facility. (This latter rule does not apply if the facility is not to be located on land and, therefore, where

the initial work on the facility must begin elsewhere.) In this case, as in the case of the commencement of construction of a building, construction begins only when actual work at the site commences; for example, when work begins on the excavation for footings, etc., or pouring the pads for the facility, or the driving of foundation pilings into the ground. Preliminary work, such as clearing a site, test drilling to determine soil condition, or excavation to change the contour of the land (as distinguished from excavation for footings), does not constitute the beginning of construction, reconstruction or erection.

The conferees wish to clarify the application of the plant facility rule where the original construction of a power plant is pursuant to a written specific plan of a taxpayer in existence as of March 1, 1986 (December 31, 1985, in the case of the investment tax credit), and both the original construction and more than one-half of the total cost of the property to be used at the power plant has been incurred or committed by such date. The plant facility rule will apply to the power plant even though the type of fuel to be utilized at the plant may have changed subsequent to the original plan and other changes may be made to accommodate the change in the fuel source, as long as more than one-half of the total cost of the plant, including all conversion costs, were incurred or committed by March 1, 1986.”

Transition rules are to be “strictly construed.” See, e.g., United States v. Commonwealth Energy Systems and Subsidiary Companies, 235 F. 3d 11 ( 1<sup>st</sup> Cir. 2000); Bell Atlantic Corp. v. United States, 224 F. 3d 220 (3<sup>rd</sup> Cir. 2000); Apache Bend Apartments, Ltd. v. United States, 987 F.2d 1174 (5<sup>th</sup> Cir. 1993); United States v. Kjellstrom, 916 F. Supp. 902 (W.D. Wis. 1996). The transition rules were enacted to provide relief “to a very, very few specified favored taxpayers,” Apache Bend, and although they must extend to all qualifying taxpayers there interpretation is not to be broadened so that entities that did not detrimentally rely on the old rule benefit from the transition exemption. See Commonwealth id. These cases and others concerned the application of the transition rules under the 1986 Act. Virtually every case concurs in the requirement of strict construction and narrow interpretation. Starting from this premise, we will analyze each of Taxpayer’s claims.

## Nuclear Fuel Reloads

Taxpayer heavily relies on the Conference Report language quoted above to prove its claim, hence we have quoted it in full. As best we can understand Taxpayer’s position it is that because it had binding contracts<sup>2</sup> to purchase the nuclear fuel and the fuel was for the Station, then it is part of the written specific plan for the equipped building/plant facility and therefore qualifies for transition relief. We do not agree. We believe that Taxpayer has already obtained the benefit of its bargain under the

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2. Because the Taxpayer did not place the fuel rods into service by the applicable date for property of its class life, it cannot obtain relief under the binding contract transition rule even though it had binding contracts before 12-31-85. Accordingly, it must bootstrap this property into the equipped building/plant facility rule in order to get transition relief.

transition rule when it placed the Station into service and was granted transitional ITC for a fully equipped and functional plant facility. To allow the rule to continue to apply after the fully equipped and functional plant was placed in service would be reading into the statute “an equipped and RE-equipped building or plant facility.” In our view, given the mandate of strict and narrow construction of transition rules, we find the expansive reading Taxpayer advocates unacceptable.

Taxpayer also seems to rely on the language in the Conference Report that states “under the equipped building rule, the conference agreement will not apply to equipment and machinery **to be used** in the completed building” (emphasis added).<sup>3</sup> That is, because this is property used in the equipped building/plant facility that it therefore *de facto* is transition property since it is agreed that Station did qualify for transition relief under section 203(b)(1)(C) of the Act. As will be discussed in greater detail with regard to other aspects of Taxpayer’s claim, we find this to be, again, an overly broad interpretation of the statute in contravention to Congressional intent of limited transitional relief.

Taxpayer also relies on Rev. Rul. 76-142, 1976-1 C.B. 88, which concerned the application of the equipped building transition rule in a prior repeal of the investment credit by the Tax Reform Act of 1969, 1969-3 C.B. 10, 110. In that revenue ruling, the taxpayer placed transition property into service partly in one year and the rest in a subsequent year. The ruling held that under the rules then in effect that the portion of the building placed in service in the first year was eligible for 3/7 of the amount of qualified investment and 4/7 for the balance of the property completed and placed in service in the subsequent year.

We believe Taxpayer’s reliance on Rev. Rul. 76-142 to be misplaced. There was no issue in the ruling as to whether or not the property was in fact transition property. It is a given fact that the property was transition property. The only issue was the correct percentage of credit (either 3/7 or 4/7) that the taxpayer was eligible for since that percentage changed depending on when construction began or was completed. In the instant case, however, the fundamental issue is whether Taxpayer has transition property to begin with. Accordingly, we do not find the ruling to be supportive of Taxpayer’s position.

### Station Equipment and Machinery

As noted, Station did qualify for transition relief under section 203(b)(1)(C) of the Act and was granted such relief for both ACRS and ITC purposes. Because of that fact, Taxpayer asserts that, pursuant to the Conference Report “all machinery and equipment **to be used** in the facility” is eligible for transition ITC. Taxpayer further asserts that there is no requirement that the machinery or equipment be placed in service with the building nor that it be identified in the pre-1986 written plan of construction. We disagree.

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3. Taxpayer also relies on this language in support of the other property addressed later in this memorandum.

Taxpayer's assertion that because the property is used in the equipped building qualifies *de facto* the machinery and equipment for transition relief would leave the statute completely open ended. That is, there would be no final placed-in-service requirement for such equipment and, ultimately, it would never be certain when the building was placed in service and whether it is in fact transition property. For example, using Taxpayer's analysis a taxpayer has a written plan to construct a building with equipment costing \$180x. The taxpayer incurs or commits to \$100x before 12-31-85. The taxpayer builds the building and equips it and places it in service in 1986. In 1988, the taxpayer buys additional machinery and equipment used in the building for \$10x. At this point taxpayer has still incurred or committed more than 50 percent before 12-31-85 (\$100x of \$190x total). In 1989, taxpayer buys additional machinery and equipment used in the building for \$9x (perhaps replacement equipment for the original equipment in the plan or just additional equipment that is helpful to the manufacturing process). Taxpayer still passes the 50-percent test. In 1990, taxpayer buys an additional \$10x of equipment used in the building. At this point, the 50-percent test is flunked and, accordingly, there never was any qualifying transition property from the inception. Hence, although we are 4 years out from the original placed-in-service date, there never was *ipso facto* any eligible transition property because the 50-percent test has been flunked. Hence, all credit would be recaptured which is also in contravention to the ordinary recapture rules that would allow retention of 20 percent of the credit each year. Clearly, transitional rules cannot be so opened ended and of uncertain application as would be the case if Taxpayer's analysis is correct<sup>4</sup>. Aside from violating the requirement of strict construction Taxpayer's analysis leads to uncertainty. Accordingly, we reject Taxpayer's position.

Further, under Taxpayer's analysis there would be no "sunset" of the transition rule. The 1986 Act itself makes December 31, 1990, the last placed-in-service date for property under the transition rules. Yet, under Taxpayer's analysis, once the building is placed in service by the applicable date (i.e., before 1991) then all property "used" in that building is transition property since pursuant to the footnote in the Conference Report the property incorporated into the equipped building need not independently meet the placed-in-service date provided the building does.<sup>5</sup> Hence, machinery and equipment used in the building even after the ordinary 1990 sunset date would continue

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4. In the instant Taxpayer's case Taxpayer had incurred or committed sufficient amounts that it will not flunk the 50-percent if the additional property is treated as transition property. But, nevertheless, the logical extension of Taxpayer's position is as in the example, and certainly there would be some taxpayers that would be in such a bind. We are also certain that if the Commissioner asserted that such additional property had to be counted--even if the taxpayer didn't claim transition relief--that the taxpayer would be arguing, as we do herein, that this after acquired property is NOT transition property and therefore should not taint the originally qualifying equipped building.

5. This is a logical explication of the statute since it would be impossible to place the machinery into service before the building is placed in service. However, the property the footnote is talking about is the original property in the written specific plan.

to qualify under Taxpayer's analysis<sup>6</sup>. That is, of course, until the costs of such equipment makes the taxpayer flunk the 50- percent test--which could be well beyond the ordinary 5-year recapture period for ITC and even beyond the statute of limitations for the assessment of deficiencies. When taken to their logical conclusions it is readily apparent that the Taxpayer's position cannot be correct.

### Replacement Property

Taxpayer asserts that because the RCP shafts and other property replaced were in the original written plan, then the replacement of that property merely is a substitution for the original property and therefore continues to be eligible for the credit. As we noted with regard to the reloads of the nuclear fuel rods, we do not believe the rule to be the "equipped and RE-equipped building or plant facility rule." Taxpayer received transition relief for the original RCP shafts as well as all of the other original equipment that was subsequently replaced. Again, it got the benefit of its bargain and its detrimental reliance. Further, as we noted above, this would result in the transition rule being open-ended and uncertain, since whether the 50-percent test is passed when the building was placed in service would not be known until all of the costs of the after-acquired replacement property was added into the total cost. Further still, again we would have the result that the transition rule never sunsets since not only would replacement of the entire plant described in the written plan be permitted as a "substitute" for the original equipment why would not the replacement of the replacement equipment be allowed as a substitute for the substitute ad infinitum. Accordingly, again, when Taxpayer's position is taken to its logical extension the results are an unacceptable expansive reading of the transition rules and uncertainty.

### Required Machinery, Equipment, and Appurtenances

At the time operations began at Station, there was still a wide range of machinery, equipment and "appurtenances" that the plant needed to operate efficiently. Some of this equipment was required by the NRC to be installed during refueling outages. Taxpayer asserts, again, that because this machinery and equipment is "used" in a qualifying plant facility is dispositive of the issue. For the reasons articulated above, we reject that contention. Further, Taxpayer's misplaced reliance on Rev. Rul. 76-142 as earlier noted is of no moment. Of greater support to Taxpayer is the language in the Conference Report concerning "incidental machinery, equipment and structures adjacent to the building (referred to here as appurtenances) which are

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6. Taxpayer asserts that the last placed-in-service date would be 1990, that is that the property described in section 203(b)(1)(C) of the Act is deemed to be 20-year property for placed-in-service requirements. We are at a loss to see how the government could enforce such a date if Taxpayer's analysis of the statute is accepted. Section 203(b)(2)(C)(ii) of the Act does provide for the later 12-31-90 placed-in-service date for transition property described in the section 204(a) transition rules but it does not modify the section 203(b)(1) rules at issue herein.

necessary to the planned use of the building.” However, for the following reasons we do not believe Taxpayer’s property qualifies.

First, in interpreting statutory language, courts look first to whether the relevant statutory language itself is plain and unambiguous. See United States v. Ron Pair Enters, Inc., 489 U.S. 235, 241 (1989); Chevron, U.S.A. Inc., v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842 (1984). If the statutory language is plain and unambiguous, courts ordinarily do not look beyond the statutory language. If the statutory language is ambiguous, courts may consider legislative history. See Robinson v. Shell Oil Co., 519 U.S. 337, 340 (1997). Hence, it is not known whether a court will resort to the Conference Report when it examines this transition rule. We do know that other courts have not gone beyond the statute when analyzing other ACRS/ITC transition rules in the 1986 Act. See, e.g., Airborne Freight, *supra*.

Secondly, even if the Conference Report is consulted, it appears that the language concerning incidental machinery and appurtenances is contrary to the explicit language of the statute since it is not required as part of the written specific plan nor counted against the 50-percent test. Whether a court would follow this extra-statutory legislation via Conference Report is uncertain.

Lastly, we do not think that it matters in any event since the property in question while being helpful and useful in the operation of the plant was clearly not “necessary” to such operation as required by the language in the Conference Report. This property was not absolutely essential or indispensable, i.e., “necessary,” to the operation of the plant as evidenced by the fact that the Station was placed in service and began generating electricity without such machinery, equipment and “appurtenances.” Accordingly, even using the somewhat dubious language of the Conference Report, Taxpayer’s property does not qualify.

In summary, we find Taxpayer’s claim to be specious, but, in all events, without merit.

A copy of this technical advice memorandum is to be given to Taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.