

**ALABAMA DEPARTMENT OF REVENUE
REVENUE RULING 01-002**

This document may not be used or cited as precedent. Ala. Code §40-2A-5(a) (1998 Replacement Volume).

TO:

FROM: Commissioner of Revenue
Alabama Department of Revenue

DATE: May 29, 2001

RE: Applicability of Ala. Code §40-9B-1 et seq., Ala. Code §40-18-190-203 to a taxpayer's planned facility.

FACTS

The facts as represented by the Requestor are as follows:

I. Factual Background

Corporation "A" plans to construct, own, and operate Company "B" in "X" Alabama. Company "B" will be a natural-gas fueled co-generation facility serving the thermal energy needs of an industrial manufacturing facility ("Company C") owned and operated by Company "C", and located near City "Y" in "X", Alabama. Pursuant to a long-term lease agreement, Company "B" will be located on land owned by Corporation "C", on the same premises, and immediately adjacent to Corporation "C". Corporation "C" will receive a nominal annual rent payment of \$10.00 for the use and occupancy of the land and associated easements. Corporation "A's" projected capital investment in the construction of Company "B" is approximately \$350,000,000.

A. Corporation "C" Operational Requirements

Corporation "C" is a manufacturer of various chemicals utilized in the fabrication of synthetic fibers and is engaged in industrial activities described in the United States Department of Labor's 1987 Standard Industrial Classification ("SIC") Major Industry Group 28 (Chemicals and Allied Products). Thermal and electrical energy are integral and necessary to Corporation "C's" manufacturing processors. Accordingly, Corporation "C" must secure a reliable supply of thermal and electrical energy. Moreover, such energy

must be provided in a cost-effective manner and in accordance with strict specifications with respect to the type, quantity, and quality of energy provided. In order to assure the provisions of these indispensable inputs and to preserve the economic viability of their manufacturing facility, Corporation "C" is entering into a 20-year Lease, Steam Sales, and Shared Services Agreement with Corporation "A" including an option to renew for three consecutive periods for up to five years each period.

These critical energy inputs have been and are currently obtained by purchasing electricity from an Authority and by generating thermal energy, in the form of pressurized steam, via the operation of coal-fired boilers operated and maintained by Corporation "C" and located on Corporation "C's" premises. Corporation "C" has determined, however, that its current means of securing these necessary inputs are no longer economically sustainable. Corporation "C" has elected to outsource its thermal and electrical energy requirements in order to maintain the economic viability of the manufacturing facility.

B. COMPANY "B" Design, Location, and Operation

Company "B" is being constructed for the purpose of meeting Corporation "C's" critical energy needs and the design, location, and operation of the facility reflects this purpose. Company "B" will utilize co-generation technology for the primary purpose of providing Corporation "C" with both thermal and electrical energy. Company "B" will consist of one steam-turbine and three combustion-turbines with their own heat recovery steam generators.

1. Corporation "C"'s Reliance on Company "B"

Based upon current *pro forma* projections, Corporation "C" will consume a majority of Company "B's" energy output (consumption is estimated at approximately 73 percent of Company "B's" total output). Corporation "C's" thermal energy requirements will be provided entirely by Company "B", and Corporation "C" will lease 20 percent (140 MW) of Company "B's" nominal generating capability (700 MW). Additionally, Corporation "C" will be completely dependent upon Company "B" for its required supply of purified, deionized water. Corporation "C" will obtain 1000 gallons per minute of deionized water from Company "B" with an option to increase its consumption to 1500 gallons per minute.

a. Thermal Energy

Corporation "C" currently obtains its entire thermal energy requirement from its existing coal-fired boilers. However, Corporation "C" will phase-out the operation of its boilers over a period of approximately two years. Thereafter, Company "B's" entire thermal-energy output will be devoted to providing 100 percent of Corporation "C's" thermal energy requirements. As a result, Corporation "C's" manufacturing operations will be completely dependent upon Company "B" providing a reliable, uninterrupted, supply of thermal energy

complying with Corporation "C's" precise specifications, as set forth in the Steam Sales Addendum, with respect to the type, quantity, and quality of energy provided.

In order for Company "B" to fulfill its primary purpose as a supplier of thermal energy to Corporation "C", Company "B" is being constructed on Corporation "C's" land immediately adjacent to and physically connected and integrated with Corporation "C". Company "B" could not produce and deliver thermal energy in satisfaction of Corporation "C's" specifications from a remote location. In order to satisfy these requirements, it is necessary to produce the thermal energy at a site that is in close physical proximity to Corporation "C". But for Corporation "C's" thermal energy requirements, Company "B" would not be constructed and operated at this location. Therefore, Corporation "C's" thermal energy requirements have effectively dictated Company "B's" site location.

b. Electrical Energy

Additionally, Corporation "C's" industrial manufacturing processes and activities require electrical energy. In order to satisfy these requirements for reliable cost-effective electrical energy, Company "B" will lease 20 percent (140 MW) to the nominal generating capability (700 MW) of Company "B". Although Company "B" will also sell electricity to wholesale purchasers, the Steam Sales Addendum, demands that steam sales to Corporation "C" have priority at all times to the sale of electric capacity or energy at the Company "B" to wholesale purchasers. Moreover, Company "B's" sale of electricity to wholesale purchasers will serve to subsidize the production of thermal energy thereby resulting in lower-cost thermal energy for use by Corporation "C". It is anticipated that Company "B's" electrical energy sales to the wholesale market will occur during peak energy consumption periods.

c. Water Requirements

Company "B" will provide 100 percent of Corporation "C's" treated water requirements. The availability of virtually 100 percent pure, deionized water is necessary and integral to Corporation "C's" manufacturing processes. Company "B" will utilize a state-of-the-art water treatment plant to provide Corporation "C" with its required supply of up to 1000 gpm of purified, deionized water with an option to increase the supply to 1500 gpm.

2. Cost Reduction Effects

Company "B's" production of thermal energy will help to reduce Corporation "C's" energy and maintenance costs due to the savings achieved through the retirement of its boiler. If Corporation "C" did not require a supply of thermal energy from Company "B" for its manufacturing processes, then Company "B" would not be constructed.

3. Integration of Facilities

Company “B” and its operations will be fully integrated with Corporation “C’s” manufacturing facility. Corporation “C” is providing the necessary easements and piping connections between each facility. Additionally, Company “B’s” raw water requirements will be drawn from a river through Corporation “C’s” existing intake infrastructure, including pump-buildings and pipelines, located on Corporation “C’s” property. Company “B’s” wastewater treatment requirements will also be fully integrated with Corporation “C’s” infrastructure insofar as wastewater from Company “B” will be discharged into Corporation “C’s” system for treatment and disposal.

ISSUES

(1) Whether the facility to be constructed by the Taxpayer will be considered “industrial development property” under Ala. Code § 40-9B-3(5)?

(2) Whether the facility to be constructed by the Taxpayer will be considered “industrial, warehousing or research activity” under Ala. Code § 40-18-190(6)?

LAW AND ANALYSIS

(1) The Tax Incentive Reform Act of 1992, Ala. Code § 40-9B-1 et seq., provides for the abatement of non-educational ad valorem taxes, construction-related transaction taxes and mortgage and recording taxes with respect to private use industrial property. In order for property to qualify, it must be private use industrial property defined under Ala. Code, §40-9B-3(13) as “private use property that also constitutes industrial development property.” Ala. Code §40-9B-3(5) defines industrial development property as “real and/or personal property acquired in connection with establishing or expanding an industrial or research enterprise in Alabama”. In turn, Ala. Code §40-9B-3(6) defines “industrial or research enterprise” as “any trade or business described in 1987 standard industrial classification industry Group Number O724, Major Groups 20 to 39, inclusive, 50 and 51, Industrial Group Number 737, and Industrial Numbers 4613, 8731, 8733, and 8734, as set forth in a Standard Industrial Classification Manual published by the United States Government Office of Management and Budget.” Id. Company “B’s” primary business function will be to supply thermal and electrical energy to Corporation “C”. In other words, Company “B” will be providing an electrical service. Electric, gas, and sanitary services are contained in Major Group 49, which is not a qualifying SIC Code as delineated in Ala. Code §40-9B-3(6). While Corporation “C” engages in a trade or business described in SIC Major Group 28, Corporation “C” and Company “B” are separate entities, and Company “B” cannot adopt Corporation “C’s” qualifying SIC Code. While the Requestor states that thermal and electrical energy are necessary to Corporation “C’s” manufacturing processes, this does not matter in making the determination whether Company “B” is industrial development property. Major Group 28, Corporation “C’s” qualifying SIC Code,

does not provide that integrated and necessary operations of producing and fabricating of synthetic fibers are included in that qualifying Major Group. Therefore, based on the facts presented, the Taxpayer's planned facility does not fall within a Major Group as specified in Ala. Code § 40-9B-3(6).

(2) Ala. Code § 40-18-192 provides that “[s]ubject to compliance with § 40-18-193, each investing company shall, upon filing of the statement required by § 40-18-191 and upon the making of qualified investments and upon compliance with subsection (a) of § 40-18-193, be entitled to the capital credit, such credit to be allocated and available in accordance with subsection (b) Section 40-18-194. Section 40-18-190(11) defines a “qualifying project” as one in which the capital cost are not less than \$2,000,000 and the trade or business activity conducted will constitute an “industrial, warehousing or research activity.” §40-18-190(6) defines “industrial, warehousing or research activity” as any “trade or business described in 1987 Standard Industrial Classification Major Groups 20 to 39, inclusive, 50 and 51, Industrial Group 737 and Industrial Numbers 4613, 8731, 8733, and 8734, as set forth in the Standard Industrial Classification Manual published by the United States Government Office of Management and Budget. ...”

For the reasons described in paragraph 1 above, the activity conducted at the planned facility does not fall within a Major Group specified in Ala. Code § 40-18-190(6).

HOLDING

(1) Taxpayer's planned facility does not qualify as an "industrial or research enterprise" as defined in Ala. Code § 40-9B-3(6).

(2) Taxpayer's trade or business activity conducted at its planned facility does not constitute "industrial, warehousing or research activity" as defined in Ala. Code § 40-18-190(6).

MICHAEL PATTERSON, Commissioner
Alabama Department of Revenue

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