ACTION ON DECISION

Subject: *Stine, LLC v. United States*, No. 13-03224, 2015 WL 403146 (W.D. La. Jan. 27, 2015)

Issue: Whether the taxpayer's two buildings were placed in service for depreciation purposes in 2008, thereby allowing the taxpayer to deduct Gulf Opportunity Zone additional first year depreciation for those buildings?

Discussion: The taxpayer operates retail stores, selling building materials and supplies to consumers and contractors. In 2007, the taxpayer began construction of two new buildings in the Gulf Opportunity Zone (GO Zone) to function as retail stores. As of December 31, 2008, both of the buildings had received only a 30-day certificate of occupancy issued by the state fire marshal that allowed them to receive equipment, shelving, racks and merchandise and allowed employees to install or stock those items. On December 31, 2008, the buildings were not ready to operate as retail stores and customers were not permitted to enter the buildings under the certificates of occupancy then in place.

The taxpayer argued that because the two buildings were placed in service in 2008, the taxpayer was entitled to deduct GO Zone additional first year depreciation for the buildings pursuant to I.R.C. § 1400N(d)(1)(A) and (d)(2)(A)(v). The District Court agreed, holding that the buildings were placed in service when they were "substantially complete meaning in a condition of readiness and availability to perform the function for which [they were] built–in this instance to house and secure racks, shelving and merchandise." *Stine*, *supra* at *5.

Determining the date property is placed in service, for purposes of both depreciation under § 167 and the investment tax credit under § 46, requires ascertaining from the relevant facts and circumstances (1) the property's specifically assigned function, and (2) when the property is in a condition or state of readiness and availability for the specifically assigned function. Treas. Reg. §§ 1.46-3(d)(1)(ii); 1.167(a)-11(e)(1)(i).

First, the court erred in holding that the taxpayer's intended use for the buildings was to "house and secure racks, shelving and merchandise." The threshold determination in a placed in service analysis is to identify the specifically assigned function of the property in the context of the taxpayer's trade or business. *Sealy Power, Ltd. v. Commissioner*, 46 F.3d 382, 390 (5th Cir. 1995); *Brown v. Commissioner*, T.C. Memo. 2013-275 at *34-*35; *Valley Natural Fuels v. Commissioner*, T.C. Memo. 1991-341, ***aff'd without published opinion***, 990 F.2d 1266 (9th Cir. 1993) (specifically assigned function of facility

property is supported by taxpayer's stated business purpose). The taxpayer intended to use the buildings as retail stores, not to house machinery and equipment.

Second, the court erred by failing to observe the regulatory requirement that property is placed in service when it is in a condition or state of readiness and availability for its specifically assigned function; that is, when it is ready and available for regular operation and income-producing use. Treas. Reg. § 1.46-3(d)(1)(ii); *Armstrong World Industries, Inc. v. Commissioner*, T.C. Memo. 1991-326; ***aff'd***, 974 F.2d 422, 434 (3rd Cir. 1992); *see also Noell v. Commissioner*, 66 T.C. 718 (1976) (new airport runway not placed in service until it was paved and available for regular use); *Piggly Wiggly Southern, Inc.*, *v. Commissioner*, 84 T.C. 739, 748 (1985); ***aff'd on another issue***, 803 F.2d 1572 (11th Cir. 1986) (new business operations must have begun for the property to be placed in service).

The meaning of regular operational use for income production has been developed by the Tax Court and the Service in the context of electric power plants. *Oglethorpe Power Corp. v. Commissioner*, T.C. Memo. 1990-505 (facility placed in service upon sustained power generation near rated capacity); *Consumers Power Co. v. Commissioner*, 89 T.C. 710 (1987) (same). In *Sealy Power, supra*, the Fifth Circuit Court of Appeals held that an electric power plant that operated on a regular basis, but did not produce the projected quantity of electricity, may be considered placed in service. In recommending nonacquiescence to *Sealy*, the Service stated that at a minimum, the property must be in a state of readiness sufficient to produce electricity on a sustained and reliable basis in commercial quantities. *Sealy Power,* AOD 1995-10 (Aug. 7, 1995). In Rev. Rul. 76-428, 1976-2 C.B. 47, and Rev. Rul. 76-256, 1976-2 C.B. 46, the Service outlines five factors to determine whether electric power facilities are ready and available for regular operation: (1) approval of all required licenses and permits; (2) passage of control of the facility to the taxpayer; (3) completion of critical tests; (4) commencement of daily or regular operations; and (5) with respect to electric power plants, synchronization of the plant facility into a power grid.

The Commissioner will continue to litigate this issue, taking the position that (1) under § 1.46-3(d)(1)(ii), a retail store is placed in service for depreciation purposes when the building is ready and available to operate as a retail store, the function for which it was built, and (2) the store's ability to begin operations is determined by considering the applicable factors set forth in Rev. Rul. 76-256 and Rev. Rul. 76-428.

Recommendation: Nonacquiescence.

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