INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

September 30, 2008

Third Party Communication: None
Date of Communication: Not Applicable

Number: **200902011**
Release Date: 1/9/2009

Index (UIL) No.: 165.01-00, 165.07-00
CASE-MIS No.: TAM-115485-08

Director
LMSB/NRC/Group 1402

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Taxpayer =

PowerCo =
State =
Year 1 =
Year 2 =
Hurricane A =
Hurricane B =
Tropical Storm C =

ISSUE:

What is the "single, identifiable property" by reference to which Taxpayer's storm casualty losses should be determined under § 165 of the Internal Revenue Code and the corresponding regulations?

CONCLUSION:

For transmission property, the single, identifiable properties are each transmission line and each transmission substation. For distribution property, the single, identifiable properties are each distribution circuit and each distribution substation.

FACTS:

General

The taxpayer is an investor-owned electric utility headquartered in State. Through a regulated electric utility, PowerCo, Taxpayer served approximately customers during the years under examination, all located in State.

Generally, an electric utility's operation consists of generation, transmission, and distribution assets. The tax treatment of Taxpayer's generation assets is not at issue in this request.

In Year 1 and Year 2, Taxpayer's transmission system included the following major components (approximately):

- active transmission substations; and
- transmission lines, including:
  - circuit miles of 500 kilovolt (kV) lines;
  - circuit miles of 230 kV lines;
  - circuit miles of 138 kV lines; and
  - circuit miles of 69 kV lines.

In Year 1 and Year 2, Taxpayer's distribution system included the following major components (approximately):

- to active distribution substations
- to distribution circuits, including:
  - to circuit miles of 34.5 kV lines, and
  - to circuit miles of other lines.

Hurricane A struck the Taxpayer service area on , affecting customers, primarily in the . As a result of this hurricane, Taxpayer replaced the following properties:

- transformers;
- poles; and

- circuit miles of wire.

Hurricane B struck the Taxpayer service area on , affecting customers at the height of the storm, in the . As a result of this hurricane, Taxpayer replaced the following properties:

- transformers
- poles
- circuit miles of wire.

As a result of these hurricanes, Taxpayer incurred approximately $ of storm restoration costs, primarily to replace utility poles and conductors. Taxpayer, on its Year 1 tax return, claimed a $ casualty loss deduction under § 165. The loss was calculated based on the total costs to restore power to its customers affected by Hurricanes A and B.[1]

Tropical Storm B struck Taxpayer's service area on , affecting customers at the height of the storm, primarily in the . Taxpayer, on its Year 2 tax return, claimed a $ casualty loss deduction under § 165.

Calculating the amount of a casualty loss deduction under § 165 of the Internal Revenue Code and § 1.165-7 of the Income Tax Regulations requires a determination of the reduction in fair market value of the property caused by the casualty, as well as Taxpayer's basis in that property. § 1.165-7(b)(1). For a business taxpayer, both determinations are made with respect by reference to the "single, identifiable property damaged or destroyed." § 1.165-7(b)(2)(i). Determining the appropriate unit of property to use for this purpose in the present case requires a fairly detailed description of Taxpayer's transmission and distribution system, its operation and management, and how Taxpayer accounts for it for tax and non-tax purposes.[2]

Physical description of transmission and distribution system

General

Broadly, Taxpayer's T&D system includes all the property between the power plant and the end user. After electricity is generated at a power plant, the electricity travels along

[1] The restoration costs were used as a measure of the loss in value attributable to the casualty, for purposes of calculating the casualty loss deduction. See § 1.165-7(a)(2)(ii). Whether or the extent to which these costs are deductible under § 162, or must be capitalized under § 263, is an issue not addressed in this technical advice request.

[2] In this discussion, we use the term "unit of property" in a generic sense—not, as discussed later, to imply that the determination of the single, identifiable property for purposes of the casualty loss calculation is necessarily the same as definitions of the relevant "unit of property" for purposes of other Code provisions.

transmission lines to transmission substations. At the transmission substations, the voltage is increased for long distance travel. From the transmission substations, the electricity travels along transmission lines to distribution substations. At the distribution substations, the voltage is decreased. From the distribution substations, the electricity travels along distribution circuits until it reaches the end user.

Transmission lines

A transmission line carries electrical power, at a higher voltage, over long distances from a generating station to a transmission substation; from one transmission substation to another; or from one transmission substation to a distribution substation. Generally, each transmission line would include the overhead conductors, wire, poles or towers, and insulators.

Taxpayer owns approximately transmission lines. Each line is identified with a unique number and name. The transmission line consists of wound metal conductors which are attached with insulators to wood or metal support structures. The support structures are identified with a unique number, and in the case of wooden support structures, each of the poles in the structure is uniquely identified.

Although the transmission line structures are numbered for operating convenience, the structure number has no significance to the cost records. When a structure is replaced, it retains the previous number, and there is no identification of cost with that structure in Taxpayer's financial records. These structures are numbered to ensure that during a power outage, or if poles are in need of repair, the affected area can be identified and located in the most efficient manner. The number is designed to identify a certain point in the system. It does not identify the cost of the assets located at that point.

The design of the electrical system owned by Taxpayer and its neighboring electric utilities is such that if a transmission line needs to be de-energized for maintenance or repair, it can be isolated from the electrical system by operating circuit breakers at the substations on either end of the transmission line. The system also has the capability to provide electrical power to the substations through other transmission lines owned either by Taxpayer or another electric utility. Each individual transmission line is designed with reserve capacity so that in the event of an outage of another transmission line or generating unit, it can handle additional current until the system is restored to normal. The current-carrying capacity of Taxpayer’s transmission lines varies according to the voltage of the line as well as the type of conductor. Each individual transmission line is rated for normal and emergency conditions through a calculation that takes into account the location, age, voltage, type of conductor, and ambient conditions as well as other factors. This information is reported to the North American Electric Reliability Corporation, which is a regional authority with oversight responsibility for electrical utility system reliability.

In Year 1, % of Taxpayer's transmission lines were over 20 years old; % were over 30 years old; and the average age was 33 years, indicating that a substantial portion of the original tax basis of the lines had been recovered through depreciation expense.

Distribution circuits

A distribution circuit delivers electrical power from the local substation out to the end user. Generally, it would include wire, poles, insulators, pole-mounted transformers, and meters. In other words, it encompasses all property from the local substation out to the customer's location.

The distribution system is designed so that if a distribution circuit, or part of a distribution circuit, needs to be removed from service, switches in the circuit can be opened to isolate a circuit, or a section of the circuit, from the electrical system. Switches between circuits that are normally open and switches (or protective devices) within circuits that are normally closed can be closed and opened, respectively, to feed the sections of one circuit that does not need to be de-energized from the other circuit that does need to be de-energized. Each circuit contains many switches, fuses, and re-closers (protective devices) that allow the segregation of the circuit into many individual sections. This design allows Taxpayer to maintain the distribution circuits in sections, thereby minimizing the size and duration of outages. A distribution circuit serves a discrete geographic area and group of customers. To help keep track of where these groups of customers are being served from, each distribution circuit is assigned a unique number. This numbering system is used to assist in the management and outage tracking of the distribution system.

For distribution circuits, the poles are numbered and the physical location of the poles is recorded in Taxpayer's maintenance system. The pole numbers are not used to record the age of the pole, the cost of the pole, or any other financial information related to the pole. The wire, hardware, transformers, and other items of equipment on the poles are not separately numbered or identified.

Transmission and distribution substations

Substations may be on the surface in fenced enclosures, underground, located in special-purpose buildings or high-rise buildings. Generally, they contain transformers, switching, protection, and control equipment.

Transmission substations provide an interconnection between individual transmission lines, as well as a method of disconnecting or isolating transmission lines from the electrical system for maintenance or repair. A transmission line is connected to circuit breakers at each end, which are located in transmission substations. Whenever possible, the system is designed so that if a transmission line needs to be removed from service, electrical power can be furnished to the substations that it serves by other

transmission lines. A transmission substation may also have transformers which step down or decrease the voltage for delivery to other transmission or distribution substations closer to the customer. In general, as electrical power is delivered closer to the customer, the voltage is lowered in successive steps. It is more efficient to move electrical power over long distances at higher voltages. Interconnections between Taxpayer and other electric utilities are made at transmission substations, and the flow of electrical energy is monitored and measured there to determine the amount due to, or from, the other utilities.

Distribution substations generally receive electricity through a transmission line. Transformers at the distribution substation lower the voltage and connect with distribution circuits (referred to as circuits rather than lines), for distribution to the end customers. Circuit breakers at the distribution substations provide a means to disconnect or isolate the distribution circuits from the electrical system for maintenance or repair.

Major equipment located at transmission and distribution substations such as transformers, circuit breakers, oil switches, and reclosers are serial numbered, and the numbers and physical location of the equipment are recorded in Taxpayer's maintenance records.

System management and control

Generation

Operation and coordination of Taxpayer's generation system is performed by Taxpayer's Resource Coordinators located at the General Office. The Resource Coordinators consider multiple factors when making decisions about which units to operate at what capacity or whether to generate or purchase power. These factors may include fuel cost, generating unit capacity and availability, and transmission line capacity and availability. In addition, they coordinate with other electric utilities and regional regulatory authorities to conform to requirements for maintaining the stability and reliability of the electrical system in the .

Approximately % of Taxpayer's power is generated by power stations. The remaining % of its native load is supplied by wholesale providers. The power required to meet the demand of the entire system is monitored, on a continuous basis, by the Resource Coordinators, in determining at what level of power to generate at each of the power stations. It is also necessary, on a continuous basis, to determine whether it is more economical to increase production in any of the power stations or to purchase power from other power providers.

Electricity demand is monitored on a system-wide basis and not based on power usage for a particular region. The rates that taxpayer charges its customers are determined by regulatory authorities.

Transmission

Operation of Taxpayer's transmission system is controlled at the Central Transmission Operation Center ("CTOC") located in . The CTOC personnel consider multiple factors when making decisions about operating the transmission system. Some of the factors that may affect the operation of the system include system load, which generating units are operating at what level, weather, and the status of neighboring electric utilities' generation and transmission systems.

Computer modeling is used to predict the effect of making a change in the operation of the system, such as removing a transmission line from service. The CTOC is responsible for monitoring the voltage, current, and other factors of each transmission line; the purpose is to ensure that the line has reserve capacity to support the reliability of the regional electrical system in case of the failure of another transmission line or a generating station. If a transmission line is damaged during a storm or other event, circuit breakers at each end of the line automatically open and remove the transmission line from service. Line crews then inspect the line to determine the source of the failure and perform repairs as needed. If a transmission line needs to be removed from service for routine repair or maintenance, a detailed written procedure is followed with coordination between the line crews and the CTOC; the circuit breakers at each end of the transmission line are operated remotely by the CTOC to de-energize the line. The outage history of the transmission system is tracked by each individual transmission line.

Distribution

Management of the distribution portion of Taxpayer's business falls under the responsibility of a company Vice President. Taxpayer's service territory is divided into three geographic divisions: and . The Distribution Operations General Manager is responsible for the state-wide distribution operations while the three Distribution Engineering Managers located in the divisions are responsible for distribution engineering. These positions report to the Vice President. The three divisions are comprised of eight operating regions.

Customer and Community Service works with local government officials to make decisions locally about how to meet the electrical needs of the community; it also serves as a point of contact for local customers. Distribution Operations performs maintenance and construction in the operating region, reads meters, monitors the status of the system, and controls the operation of circuit breakers and switches. Personnel in Distribution Operations Control ("DOC"), which are further discussed below, report to

Distribution Operations. Distribution Engineering is responsible for design and construction of additions or changes to the distribution system in their local area of responsibility. Central Services, located at the corporate office in , provides system-wide services to all three divisions.

Operation of Taxpayer's distribution system is controlled at one of the DOCs. The DOC for each operating region controls the work and operating functions being performed on the system. However, it does not actually control the system, in that it does not have control of the equipment in the field from within the DOC. The DOC serves as the control point for operation of the distribution system. Personnel at the DOC monitor the status of the system and control the operation of circuit breakers and other devices by field maintenance personnel. The DOCs are located at and . The sites operate during normal daytime working hours and during times when outage activity is expected, such as heavy storms. The DOC assumes control of the entire distribution system when the other sites are not in operation. DOC Specialists and Operators are assigned to these locations and report to their DOC manager.

If a Taxpayer customer experiences a power outage, they call the designated phone number for outages and are connected to the Call Center at which handles outage calls for the entire system. The Call Center enters all such orders into a work order system. The DOC will then assign the call to a Line Mechanic. The Line Mechanic will determine the source of the problem and coordinate with the DOC on the operation of any switches or circuit breakers. The DOC monitors and manually records the status of all of the devices that control the flow of electricity on the distribution circuits. If a Line Mechanic needs to isolate a section of a circuit, a detailed written procedure is followed, and the DOC must give approval before the devices are operated.

The distribution circuits are protected by fuses located on poles near the customer's location and by circuit breakers located at the distribution substations. Both the fuses and circuit breakers operate automatically when a fault occurs in the circuit due to a fallen limb or a downed line or other cause. The fuses and circuit breakers must be reset manually when the circuit has been repaired and is ready to be returned to service. The Line Mechanic follows a procedure for coordinating with the DOC before resetting the devices.

When a distribution circuit or a portion of a distribution circuit is removed from service for routine maintenance, the fuses, circuit breakers, and switches are operated manually by the local crews. A detailed written procedure is followed, and the crews coordinate with the DOC when working on the circuits. The DOC maintains a record of the status of each individual distribution circuit, including such equipment as switches, circuit breakers and transformers. The records indicate whether the circuits and the

individual devices are in service and the position of circuit breakers and switches, i.e., open or closed.

The outage history of the distribution system is tracked for the entire service territory, for each region, and for each individual distribution circuit. Taxpayer and all other State utilities are required to file annual reports to the
detailing their distribution system reliability. Taxpayer is also required to have in place a program for analyzing the top 5% worst-performing circuits in each region and must describe the action taken to improve the performance of these circuits. Taxpayer is expected to have sufficient personnel, equipment, repair materials, and supplies strategically located throughout its service territory in order to meet the required reliability standards.

The also requires that all jurisdictional utilities maintain complete records of all sustained interruptions. These records include the type of interruption, the cause for the interruption, the date and time of the interruption, the restoration time for the interruption event, the number of interrupted customers, the substation identifier, the distribution circuit identifier, and any action taken to restore service and prevent recurrence.

How elements of the T&D system are bought and sold

When Taxpayer first entered the utility business in , it built its transmission and distribution system as it expanded within its franchise territory. Over the course of , it built and acquired additional capacity in several ways. First, it maintained a building program. In addition, at one point it entered into an exchange with another utility in State, pursuant to which it gave up a transmission line in in the middle of the State and acquired a transmission line in on the of . As that area's population exploded, Taxpayer built out its distribution system. In rural areas, Taxpayer may own a substation and may acquire the distribution circuits from a nearby town. In one instance, Taxpayer entered into an agreement with the City of under which the City, which owned the wires and poles, agreed that Taxpayer would replace the wires and poles whenever needed and whatever assets it replaced under the agreement, it would own. It was understood that at the end of some period of time, it would actually own the entire transmission and distribution system of the City. A similar arrangement was in place in . Another example was the acquisition of a transmission and distribution system from in .

To the extent Taxpayer adds new components to its system, it purchases them from many different manufacturers. For example, separate vendors would supply wooden poles and metal conductor for overhead circuits, while another vendor would supply transformers for distribution substations. The individual components perform functions (within the overall system function of transmitting and distributing electricity) ranging

from support of conductors, in the case of poles and insulators, to mechanical/electrical functions, in the case of circuit breakers. Each type of asset has a separate warranty according to the nature of the asset and the manufacturer.

Maintenance and repair practices

Different components of the transmission and distribution system have different maintenance plans. For example, insulators on transmission lines are inspected monthly while wooden poles are inspected and treated on a ten-year basis. Generally, Taxpayer contracts with outside contractors to maintain its transmission lines. A separate contractor is hired to inspect and treat wooden poles. Taxpayer's internal maintenance crews, Line Mechanics, maintain the distribution system.

Taxpayer maintains and repairs the assets making up its transmission and distribution system both while affixed to the system and while removed from the system. Its objective is to minimize disruption to the transmission and distribution of electricity to its customers. For example, if a distribution circuit is damaged during a storm, a crew will electrically isolate the damaged portion from the rest of the system while repairs are made. The assets being repaired, such as wire, would remain in their physical location while being repaired. Other types of assets, such as transformers or motors might be removed from service and replaced with a serviceable unit and then placed in storage, after being repaired, until needed.

Asset accounting

Regulatory and financial accounting

Historically, the utility industry has used the Federal Energy Regulatory Commission (FERC) method to account for fixed assets for both book and regulatory purposes. This method is also used to assist in determining the appropriate depreciation classification for federal income tax purposes.

Taxpayer is a regulated utility and is required to account for its assets under the Uniform System of Accounts (USoA) as prescribed by the FERC. The FERC requires that each major utility maintain records that record the cost of additions and retirements of property and equipment in the appropriate plant accounts.

Prior to 1998, the FERC's regulations prescribed detailed property-unit listings that each utility was required to use to identify the items of property and equipment tracked by its fixed-asset recordkeeping system. However, in 1998 the property-unit listing requirements were eliminated and the utilities were given the flexibility to maintain their own property listings and track the costs of fixed assets at the level of detail tailored to their business. Companies regulated by the FERC must still adopt units of property for rate-making purposes and these choices must be approved by the FERC; however,

these choices vary from company to company and are not determined by FERC regulations.

Under the current USoA, FERC accounts are specified and required to be used for each type of asset. The FERC Electric Plant Chart of Accounts used by the Company is broken down into five categories: Intangible Plant (Accounts 301-303); Production Plant (Accounts 310-346); Transmission Plant (Accounts 350-359); Distribution Plant (Accounts 360-373); and General Plant (Accounts 389-399).

For example, in the distribution system, the conductor that carries the electricity is included in "Account 365—Overhead Conductors and Devices." The conductor is supported by poles, which are included in "Account 364—Poles, Towers, and Fixtures." Transformers located at the distribution substations, which reduce voltage, are included in "Account 362—Station Equipment."

In the transmission system, metal structures that support the wire that conducts the electricity are assigned to "Account 354—Towers and Fixtures." The wire itself, however, is included in "Account 356—Overhead Conductors and Devices." Transformers that increase or decrease the voltage at the transmission substations are included in "Account 353—Station Equipment."

When Taxpayer adds fixed assets to its system, the process of accounting for the costs typically begins with a work order for the project, which is assigned a work order number and includes a description of the work to be done. Costs are accumulated in a Construction Work in Progress account. An accounting record is made for each expenditure, which includes the description, work order number, General Ledger account number, and FERC account number for direct costs.

After the job is completed and all costs have been accumulated, the direct and indirect costs are “unitized” into retirement units. Examples of retirement units would include a pole, a transformer, a switch, or a length of cable. These retirement units are then placed into the various FERC accounts based upon the FERC account descriptions. At this point, all costs are associated with a FERC account number.

For book purposes, the cost of units of property added or retired are ultimately charged to FERC accounts under the following rules:

> A. The addition or retirement of retirement units of property shall be accounted for as follows:
>
> > (1) When a retirement unit is added to electric plant, the cost thereof shall be added to the appropriate electric plant account.

> (2) When a retirement unit is retired from electric plant, with or without replacement, the book cost thereof shall be credited to the electric plant account in which it is included, determined in the manner set forth in paragraph B, below.
>
> B. The book cost of electric plant retired shall be at the amount at which such property is included in the electric plant accounts. When it is impractical to determine the book cost of each unit of property, due to the relatively large number or small cost thereof, an appropriate average book cost shall be determined from the utility's records and if this cannot be done it shall be estimated.

This use of average or estimated costs for large numbers of units of property is termed mass item accounting. Under mass item accounting, the actual costs for individual units of property are not known or reasonably determinable, and the traditional convention for retirement and book depreciation methods is to assume a first-in-first-out convention. Under the USoA, the costs of nearly all initial construction are capitalizable as "utility plant." Upon replacement or addition, only those costs associated with retirement units of property may be capitalized. The cost of replacing or adding minor items of property (*i.e.*, not retirement units of property) must be charged to operations or maintenance expense.

Large equipment is usually serial-numbered for specific identification, and, for these assets, Taxpayer maintains perpetual records. Taxpayer has accounted for its poles and other transmission and distribution assets, however, using the mass item accounting approach described above for financial statement and regulatory purposes.

Tax accounting

For tax purposes, Taxpayer uses general asset depreciation for its transmission and distribution assets.[3] To do this, it groups the FERC accounts into larger general asset accounts having the same asset class, same applicable depreciation method, same applicable recovery period, same applicable convention, and same vintage (that is, year placed in service). Some FERC accounts are divided into more than one tax class if the assets in that FERC account fall into more than one asset class for MACRS cost recovery. For example, assets in FERC "Account 362—Distribution Plant-Station Equipment" are divided into "36200-20 Year," 36200-5 Year," and "36200-7 Year."

Taxpayer uses these general asset accounts to maintain the tax depreciation records for the entire transmission and distribution system. With minor exceptions, all Taxpayer's T&D assets of a given vintage are combined as one general asset in

[3] A taxpayer may elect to account for its assets subject to § 168 (MACRS) in general asset accounts, as authorized by § 168(i)(4) and the corresponding regulations. Taxpayer asserts that it generally follows these regulations; however, it has never made an election to do so.

MACRS depreciation class 49.14, “Electric Utility Transmission and Distribution Plant.” There are no separate tax accounts or sub-records for a particular asset, sub-group of assets or region.

Because taxpayer accounts for its transmission and distribution assets using general asset accounting, it is required to maintain records that identify the assets included in each general asset account, establish the unadjusted depreciable basis and depreciation reserve of each general asset account, and reflect the amount realized during the taxable year upon disposition from each general asset account. Taxpayer is not required to maintain information related to any individual asset included in the general asset account. If it is determined that repair costs need to be capitalized, Taxpayer removes the assets remaining in the oldest remaining vintage years and correspondingly records the replacement assets in the current vintage year.

For purposes of determining its basis in the entire transmission and distribution system, the "single, identifiable property" it used for the casualty losses at issue, Taxpayer combined its tax bases in FERC accounts that included assets in the transmission or distribution system and summed their bases.

LAW AND ANALYSIS:

Law

Section 165(a) of the Internal Revenue Code allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Section 165(b) provides that the basis for determining the amount of the deduction for any loss is the adjusted basis provided in § 1011 for determining loss from the sale or other disposition of the property.

Section 1.165-7(a)(1) of the Income Tax Regulations provides that any loss arising from fire, storm, shipwreck, or other casualty is allowable as a deduction under § 165(a) for the taxable year in which the loss is sustained.

Section 1.165-7(b)(1) provides that the amount of the loss to be taken into account for purposes of § 165(a) is the lesser of either—(i) The amount which is equal to the fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty; or (ii) The amount of the adjusted basis prescribed in § 1.1011-1 for determining the loss from the sale or other disposition of the property involved. However, if business or investment property is totally destroyed by casualty, and the fair market value of the property immediately before the casualty was less than the adjusted basis of the property, the adjusted basis is treated as the amount of the loss.

Section 1.165-7(a)(2)(i) provides, in part, that in determining the amount of the deductible loss, the fair market value of the property immediately before and immediately after the casualty shall generally be ascertained by competent appraisal. However, § 1.165-7(a)(2)(ii) provides that the cost of repairs to the property damaged is acceptable as evidence of the loss of value if the taxpayer shows that (a) the repairs are necessary to restore the property to its condition immediately before the casualty, (b) the amount spent for the repairs is not excessive, (c) the repairs do not care for more than the damage suffered, and (d) the value of the property after the repairs does not as a result of the repairs exceed the value of the property immediately before the casualty.

Section 1.165-7(b)(2)(i) provides, in part, that a business or investment loss is determined by reference to the single, identifiable property damaged or destroyed. Thus, for example, in determining the fair market value of the property before and after the casualty in a case where damage by casualty has occurred to a building and ornamental or fruit trees used in a trade or business, the decrease in value is measured by taking the building and trees into account separately, and not together as an integral part of the realty, and separate losses are determined for such building and trees. Section 1.165-7(b)(2)(ii) provides a special aggregation rule under which improvements are considered an integral part of real property that is not used for business or investment.

Analysis

The parties agree that Hurricanes A and B and Tropical Storm C qualified as casualties for purposes of § 165.[4] The request for technical advice focuses on the single, identifiable property by reference to which Taxpayer's storm casualty losses should be determined.

For purposes of quantifying the loss in value attributable to the storms under § 1.165-7(b)(1), Taxpayer used the cost-of-repairs method permitted by § 1.165-7(a)(2)(ii). Largely because Taxpayer's assets have been depreciated, the basis limitation in § 1.165-7(b)(1)(ii) came into play, and the unit of property is significant because the cost of repairs may exceed basis—depending on the size of the "single, identifiable property" that is used to make the determination.

In determining the basis limitation, Taxpayer proposes that its entire transmission and distribution system (that is, not including its generation assets) is the "single, identifiable property" that was damaged by the storms. Alternatively, Taxpayer proposes that its entire transmission system constitutes one unit of property for this purpose, and that its distribution system should be grouped into the assets in each of its three operating divisions.

[4] The storms in question were major, unusual events; Taxpayer does not treat all storm damage as a casualty.

The examination team proposes that the "single, identifiable property" damaged or destroyed by the storms is each FERC retirement unit, which generally corresponds to the individual asset. Alternatively, the examination team proposes that each transmission line and distribution circuit is a separate unit of property for this purpose.[5]

In our view, Taxpayer's methods of quantifying its loss employ units of property that are unreasonably large; by the same token, use of the individual retirement unit or asset, as proposed by the examination team, is not fully supported by the factors cited in the relevant case law. We conclude that the examination team's alternate position, in which each line, circuit, and substation is treated as a "single, identifiable property," is a reasonable method to use on the facts of the present case. This conclusion is supported by the language of the regulations, and by the intent of the regulations and the factors to be used in applying them, as evidenced in the case law.

Section 165 regulations

Under the § 165 regulations, a casualty loss is determined by reference to the "single, identifiable property damaged or destroyed." The language of the regulation itself supports a relatively narrow construction of the term:

> Therein, the term 'property' is clearly adjectivally defined and limited by the phrases 'single identifiable' and 'damaged or destroyed'. . . . These descriptives or modifiers unmistakably constrict the permissible interpretation of 'property,' rather than broaden it.

Weyerhaeuser Co. v. United States, 32 Fed. Cl. 80, 100 (1994), aff'd in part and rev'd in part, 92 F.3d 1148 (Fed. Cir. 1996). An example in the regulations provides that where damage by casualty has occurred to an office building, land, and ornamental plantings, the decrease in value and the basis limitation are both measured by taking the building, land, and plantings into account separately, with separate losses being determined for each. § 1.165-7(b)(3), Ex. (2).[6]

Case law

Some general principles as to what constitutes a "single, identifiable property" can be taken from the case law.

---

[5] Although the parties did not specifically address the status of substations, we conclude that they should be treated separately from lines and circuits.

[6] By contrast, taxpayers who sustain a loss to personal-use real property, such as a home, may aggregate land, buildings, and plantings in determining their loss. § 1.165-7(b)(3), Ex. (3).

The current regulations were adopted after the courts rejected the "percentage of basis" rule for business casualty losses reflected in the prior regulations.[7] In Alcoma Association v. United States, 239 F.2d 365, 369 (5th Cir. 1956), the court pointed out the merits of a rule that permitted use of the entire basis of a functional unit of business property: "Where a partial loss of an indivisible business property is suffered it may well be necessary to restore the damage in full by immediate repairs and replacements before any portion of the property is again usable." The court cited the example of an automobile, "which cannot be destroyed piece by piece without affecting the utility of the whole, and which thus clearly has an undivisible *[sic]* 'basis.'" Id. at 368.

In response, the Service replaced the percentage of basis business rule in 1959 with the "single, identifiable property" business rule, which was later upheld by the courts. See Carloate Industries v. United States, 354 F.2d 814 (5th Cir. 1966) (land and citrus groves are separate properties); Keefer v. Commissioner, 63 T.C. 596 (1975) (land and buildings separate).

The courts have expanded on the purposes behind the basis limitation in § 165(b) generally and the "single, identifiable property" rule specifically. Generally, the basis limitation prevents a deduction for a loss of value in excess of basis, such as unrealized appreciation. See Rosenthal v. Commissioner, 416 F.2d 491, 497 (2d Cir. 1969). More specifically, the "single, identifiable property" rule ensures that a taxpayer may not borrow basis from unharmed property in order to increase the amount of a loss deduction for an injury to other property. See id. at 497-98; Keefer, 63 T.C. at 600.[8]

In a series of cases, most involving timber, the courts further developed some of the factors to be used in the determination.

In Westvaco Co. v. United States, 225 Ct. Cl. 436 (1980), storms and fire damaged the taxpayer's timberlands. The Government took the position that the "single, identifiable property" was each unit of merchantable timber contained in trees suffering mortal injury, limiting the allowable deduction to the adjusted bases of these units, as carried in the depletion accounts. The court instead determined that the "single, identifiable property" was the depletion account, or "block" (an aggregation of timber used to compute depletion), citing several factors: The depletion block was a logical and reasonable unit for purposes of valuation and accounting; was the only unit that remained constant and identifiable for tax purposes, and had a cost or adjusted basis that was not changed except by elimination of an asset or by injection of capital; was a reasonable and identifiable area affected by the casualty; was a unit that was, or could

[7] Under the percentage of basis approach, if property lost, for example, 60% of its value, the taxpayer would deduct 60% of its basis.

[8] The rule also allows a business taxpayer to recover more easily basis in property that is completely destroyed by casualty, when the drop in value is less than basis; a large unit of property is less likely to be destroyed. See § 1.165-7(b)(1).

be, normally bought and sold by the taxpayer; was consistent with the taxpayer's tax accounting for depletion purposes; did not prevent the taxpayer from realizing the full extent of the loss (physical damage to immature timber, on the facts of the case); was generally consistent with industry practice; and was chosen based in part on considerations of forestry operation and management.

Westvaco was subsequently applied in a similar timber case, Weyerhaeuser Co. v. United States, 92 F.3d 1148 (Fed. Cir. 1996), aff'g in part and rev'g in part, 32 Fed. Cl. 80 (1994), which involved casualties caused by fires, insects, and a volcanic eruption. The court reversed the lower court's determination that the "single, identifiable property" was the tree "stand" rather than the depletion block, holding that Westvaco was controlling, and agreeing with the Westvaco opinion that the depletion block "met both the accounting needs imposed by the tax code and the operational needs of effective forest management"; that it "maintained its own 'identifiable adjusted basis unaffected by other such units'"; and that it was logical and reasonable "to use the same property unit for casualty loss purposes as had been consistently used for tax accounting purposes." 92 F.3d at 1151 (citations omitted).[9]

In an issue that was not appealed, the lower court in Weyerhaeuser also agreed with the taxpayer that its seven logging road systems and a logging railroad system each constituted separate "single, identifiable properties"—rejecting the Government's position, which was based on the portions of each system that sustained damage. The Court noted that the taxpayer "built integrated road systems and a unitary railroad whose utility as assets derive from their functioning as a whole." Id. at 104. However, the Court went on to stress that its holding was limited to these single-purpose networks, which the taxpayer accounted for and depreciated as units, and as to which "no subdivision … was made by plaintiff for any reason related to identification of the assets of the company." Id. at 105. Addressing Louisville and Nashville R.R. Co. v. Commissioner, T.C. Memo 1987-616, which involved loss of railroad grading, the court distinguished a situation involving a rail system used in the primary business of operating a railroad, which "serves varied and vast areas," observing that Weyerhaeuser's logging railroad was not "commercially segmentable"; that "its function and use are to benefit a discrete realm … one area of timberland"; and that it was "one functioning unit that serves a specific and limited territory." Id. at 106.

Estate of Rinaldi v. United States, 38 Fed. Cl. 341 (1997), involved the use of the "single, identifiable property" in determining value, not basis, under § 1.165-7(b). The Government argued that the "single, identifiable property" was each individual freeze-damaged citrus tree. The court adopted the taxpayer's position that the entire citrus grove should be valued as one "realistic economic unit." Citing the timber cases, the court reasoned that the grove was the only "unit with a realistic market value." Id. at

[9] See also International Paper Co. v. United States, 39 Fed. Cl. 478 (1997). The Service conceded the issue, with respect to timber, in Rev. Rul. 99-56, 1999-2 C.B. 676, rev'g Rev. Rul. 66-9, 1966-1 C.B. 39.

355. The court noted the case law's common-sense approach to casualty loss calculation, the practical operation of the taxpayer's citrus grove, and the purpose and method of the taxpayer's appraisal.

Summarizing, the determination of the "single, identifiable property" involves the application of a number of factors, none of which is dispositive, to arrive at a reasonable unit of property taking into account the nature of the casualty and the facts and circumstances of the particular case. Although we must be cautious in applying cases involving timber or trees to the present situation, some of the factors to be looked at include:

- whether the unit chosen is reasonable in relation to the nature and scope of the casualty;
- whether it reflects all the physical damage caused by the casualty;
- whether it remains constant and identifiable for tax purposes, and has a cost or adjusted basis that is not changed except by elimination of an asset or by injection of capital;
- whether it is consistent with the taxpayer's other tax accounting practices (for example, depletion in the timber cases);
- whether it is accounted for and identifiable as a unit for non-tax accounting purposes;
- whether it is a unit whose utility derives from its functioning as a whole;
- whether it is separately treated for operational and management purposes;
- whether it is a "commercially segmentable" unit likely to be bought or sold as such; and
- whether it is consistent with industry practice.

In applying these factors, we should take into account the purpose of the "single, identifiable property" rule, which is to arrive at a logical, reasonable, and practical unit for valuation and accounting purposes, while preventing the borrowing of basis from unharmed property, without segregating the damaged property into artificially small subunits. We will discuss the parties' alternate positions in turn.

Entire transmission and distribution system as the "single, identifiable property"

Taxpayer's primary position is that the "single, identifiable property" damaged by the storms was its entire transmission and distribution system, serving over customers through a large portion of State, and composed of approximately substations, transmission lines, distribution circuits, and over circuit miles of wire and cable. We believe that this extensive aggregation of assets is not a reasonable "single, identifiable property," and that this position does not comply with the regulations under § 165.

Reasonable in relation to the nature and scope of the casualty

In terms of the factors identified in the case law, use of the T&D system does not accurately reflect the nature and scope of the casualty, and permits too much "borrowing" of basis from undamaged assets. Under Taxpayer's position, it would be able to draw on the basis of its entire T&D system, no matter how large or small the casualty. For example, the damage caused by Hurricane B in Year 1 required replacing transformers, poles, and circuit miles of wire; in the same year, Hurricane A resulted in the replacement of only transformers, poles, and circuit miles of wire. Yet in both cases Taxpayer argues that the "single, identifiable property" was the same, and that it could draw basis from its entire T&D system. Just as, in the regulations, see § 1.165-7(b)(3), Ex. 2, a business taxpayer cannot draw basis from its land or building in determining a casualty loss to trees and shrubs on the same property, so here Taxpayer, in determining a casualty loss for damaged distribution circuits in one part of State, should not be able to draw basis from an untouched transmission substation on the other side of State.

Functional and operational unit

In terms of the "single, identifiable property" as a functional unit, Taxpayer argues that its entire T&D system derives its utility from its function as a whole. While this is true, in a sense, such larger systems are in turn composed of lines, circuits, and substations, each of which is a discrete "system" of components that has its own function, operating as a unit to transmit, convert, switch, or distribute electricity. Taxpayer's argument proves too much, in that one could as easily include its generation assets as part of a *larger* system, or regard all of the depreciable assets in its entire electric business as one integrated system, on the ground that they are centrally managed and designed to work together to perform an overall function. So long as we do not artificially subdivide a taxpayer's assets into unrealistic units, we do not interpret the "single, identifiable asset" rule as requiring the largest possible aggregation of property.

Taxpayer cites to the case of the logging road and rail systems at issue in Weyerhaeuser. However, the court in that case took pains to limit its holding to a unitary network constructed as an adjunct to a taxpayer's business, as to which "no

subdivision … was made … for any reason related to identification of the assets of the company," and which served a "specific and *limited* territory." See 32 Fed. Cl. at 106 (emphasis added). Taxpayer, in contrast, *does* subdivide its T&D system into identifiable lines, circuits, and substations. The Weyerhaeuser court went on explicitly to distinguish a situation like the current one, in which a network is itself the primary business of Taxpayer, serves large and varied areas, and can be (and has been) bought and sold in "commercially segmentable" units smaller than an entire system.

From an operational standpoint, use of a smaller unit is also consistent with how a storm or similar casualty affects Taxpayer's business and how Taxpayer corrects the situation. Although there have been occasional widespread "blackouts" in the electric industry, few casualties would bring down an entire T&D system. As discussed further below, Taxpayer's focus in recovering from a casualty is to repair or replace those segments of the system—lines, circuits, or substations—that have been damaged, and to restore power to the particular areas affected by the damage. Extra capacity, redundancy, and workarounds are built into the T&D system, so that each of these smaller units is generally capable of being de-energized for repair without degrading the function of the rest of the system—and, in some cases, without significantly interfering with the function of the system at all.

Commercially segmentable

With respect to this factor, the record shows that while an entire T&D system *may* be the subject of an acquisition or sale, it is not uncommon for subunits of an entire system to be acquired or sold. For example, Taxpayer may own a substation and acquire the related distribution circuits, previously owned by a local jurisdiction, and it has exchanged transmission lines with another utility in the past.

Logical management unit

Taxpayer asserts that its entire T&D system is a logical management unit. Again, just as the assets of most businesses can be viewed as made up of systems within larger systems, so too most businesses are hierarchical and are managed at several levels. We do not interpret the "single, identifiable property" rule as calling for the assets subject to the largest possible span of management control to be treated as one property.

The record shows that Taxpayer's transmission and distribution systems are managed separately. Moreover, within the transmission system, the voltage, current, and other factors of each transmission line are monitored to ensure the line has the proper reserve capacity. Additionally, each individual transmission line is rated for normal and emergency conditions through a calculation that takes into account the location, age, voltage, type of conductor, and ambient conditions as well as other factors. This information is then reported to the North American Electric Reliability Corporation.

Taxpayer's distribution system is controlled by Distribution Operation Controls, each of which monitors the status of the system and controls the operation of circuit breakers and other devices. These DOCs do not necessarily define a specific area: the DOC, for example, sometimes manages the entire distribution system and sometimes only one region. Together, the DOCs manage the distribution system as a unit, each distribution region as a unit, *and* each individual distribution circuit as a unit. For example, the outage history of the distribution system is tracked for the entire service territory, for each region, and for each individual distribution circuit. Additionally, Taxpayer is required to have in place a program for analyzing the top 5% worst performing circuits in each region, and must describe the action taken to improve the performance of these circuits.

In any event, no one factor is dispositive in the determination of the "single, identifiable property." In Westvaco, for example, the taxpayer actually grouped its timberlands into "woodlands" for management purposes, each with a manager responsible for development, sales, logging, protection, property tax, and accounting. See 639 F.2d at 718. Yet, based on other factors, the court considered each of the 10 depletion blocks in the taxpayer's Southern Woodlands a separate "single, identifiable property." Id. at 719.

Consistent with tax accounting practice

Finally, taxpayer argues that use of its entire system is consistent with its tax accounting practice since, with minor exceptions, all Taxpayer's T&D assets of a given vintage are combined in one general asset account for asset class 49.14, "Electric Utility and Transmission and Distribution Plant," of Rev. Proc. 87-56, 1987-2 C.B. 674. It can be argued that this general asset account is analogous to the depletion block in the timber cases: the smallest identifiable unit that remains constant and identifiable for tax purposes, and has a constant basis. Arguably, under the case law, Taxpayer should not be required to allocate basis to some smaller unit of property, such as the line, circuit, or substation.

It appears that since the taxpayer did not make an affirmative election to apply the rules for general asset accounting in § 1.168(i)-1, it is not technically subject to those rules, although it may have followed them in certain respects. In fact, it is not clear whether Taxpayer's accounting for tangible depreciable assets is proper. This issue is outside the scope of the technical advice request. For present purposes, it is sufficient to note that, unlike the depletion regulations at issue in the timber cases, the depreciation rules have consistently provided for an allocation of the basis of assets in a group, composite, mass asset, or general asset account, in the case of a casualty loss. Nowhere in the

depreciation regulations or case law is there any indication that the basis in such an account is "indivisible" for casualty-loss purposes.[10]

This can be seen by comparing the treatment of casualty losses under varying depreciation regimes.

Certainly, a taxpayer that depreciates on a single-asset basis would have the information necessary to estimate the basis attributable to such combinations of assets as electrical lines, circuits, and substations.

Under the older regulations promulgated under § 167, provision was made for accounts containing multiple assets, such as group, classified, or composite accounts. § 1.167(a)-7(a). Losses were permitted with respect to, among other events, abnormal retirements, which included casualty losses. § 1.167(a)-8(b). However, the basis to be used in such a case was not the basis of the entire group account, but rather the basis of the lost assets, adjusted for depreciation. § 1.167(a)-8(c).

Similarly, under the Class Life Asset Depreciation Range (CLADR) depreciation rules, the regulations permitted "extraordinary retirement" losses from a mass vintage account, including casualty losses to depreciable business property. § 1.167(a)-11(d)(3)(ii). However, unless the asset retired was the only or last asset in the account, the regulations provided that "the unadjusted basis of the retired asset shall be removed from the unadjusted basis of the vintage account," with appropriate adjustments to the basis of the account. § 1.167(a)-11(d)(3)(iv).

Finally, the general asset account regulations under § 168(i)(4), the principles of which Taxpayer purports to follow, are consistent in this respect with the treatment of casualties in prior depreciation regimes. Under these regulations, unless the assets lost in a casualty were the last or all the assets in a general asset account, a casualty loss deduction is only available if the taxpayer elects to treat the casualty as a "qualifying disposition." § 1.168(i)-1(e)(3)(iii)(B)(1); § 1.168(i)-1(i). As in the case of prior depreciation systems, a taxpayer must identify the assets that were lost as a result of the casualty and make an allocation of basis to those assets, using "any reasonable method." § 1.168(i)-1(e)(3)(iii)(A); § 1.168(i)-1(i). Though Taxpayer did not elect to use general asset accounts under these regulations, we cite them to demonstrate that the depreciation rules have consistently treated casualties to a multiple asset account as requiring an allocation of basis to reflect the assets, or groups of assets, actually damaged or destroyed by the casualty.

---

[10] This distinction between the timber depletion regime and the depreciation regime has an underlying conceptual justification: timber grows; depreciable assets do not. Thus, while individual trees in a timber depletion account do not and cannot have an identifiable basis—only a deemed "depletion unit" that is adjusted annually based on estimates of changing timber volume—tangible depreciable assets that are grouped together for accounting convenience remain, in fact, distinct assets that do not change or grow, and as to which an allocation of basis can be made if necessary.

Accordingly, we believe that the timber cases are distinguishable, and that the fact that Taxpayer has chosen to depreciate on a multiple-asset basis does not require recognition of its entire transmission and distribution system as one "single, identifiable property" for purposes of calculating its casualty losses (a position that would give the taxpayer an undue advantage over other taxpayers who depreciate on a single-asset basis and therefore have an identifiable basis for each asset or grouping of assets).

For the foregoing reasons, we consider Taxpayer's use of its entire T&D system as one "single, identifiable property" for purposes of applying the § 165 regulations to be incorrect.

Transmission system, and each distribution management region, as a "single, identifiable property"

Similarly, for the reasons discussed above, we do not agree with Taxpayer that the alternative position it developed in a supplemental submission would be a reasonable division of its assets for the purposes of § 165.[11] The primary justification for this breakdown is based on Taxpayer's management structure—which, as discussed above, is a relevant but not dispositive factor. While use of these smaller units would better reflect the nature and scope of a casualty than would use of the entire T&D system, it could still permit extensive "borrowing" of basis from assets distant from, and untouched by, a casualty. In terms of the other factors relevant to the determination, the case for this division of assets is, if anything, even less persuasive than the case for using the entire T&D system.

Each FERC retirement unit as the "single, identifiable property"

The examination team's primary position is that each FERC retirement unit, generally corresponding to an individual asset, should be regarded as the "single, identifiable property" damaged or destroyed by these casualties.

Certain factors tend to favor the use of the retirement unit as the "single, identifiable property." It reflects industry practice and how Taxpayer accounts for fixed assets for both book and regulatory purposes. The overall USoA accounting system is uniform, although it now provides a certain flexibility for companies to choose their own retirement units. The retirement unit is the lowest level of accounting: when a project is completed, its direct and indirect costs are "unitized" into retirement units and grouped into FERC accounts—which in turn form the basis, with adjustments, for the general asset accounts that Taxpayer purportedly uses for tax purposes. Finally, treating each

[11] Taxpayer's representatives originally discussed a division of assets based on political boundaries, stating that Taxpayer maintained records of assets on that basis for property-tax and regulatory reasons. However, its proposal as eventually submitted was based on larger units of property.

retirement unit as a "single, identifiable property" would arguably best reflect the nature and scope of the casualty and prevent the borrowing of basis from undamaged assets.

For several reasons, however, we believe use of the retirement unit is not consistent with the purpose of the "single, identifiable property" rule and the case law interpreting it. First, while the definition of property for regulatory purposes may in some cases be a factor relevant to the determination—since it is one way of rendering a unit of property "identifiable"—we do not feel that this factor is dispositive. Second, while every asset can be said to have a function, Taxpayer does not manage its operations on an asset-by-asset basis; for example, it monitors and tracks the performance and reliability of individual lines and circuits, but not necessarily every individual *component* of that circuit—which, unlike lines and circuits, are not always numbered for identification. Third, while Taxpayer may acquire individual assets for construction and repair purposes, it does not customarily sell assets individually or in bulk as "commercially segmentable" units, although it may buy or sell lines, circuits, or substations.

Finally, use of each retirement unit or asset as a "single, identifiable property" might not reflect accurately the nature and scope of the damage caused by a casualty. For example, if a circuit is damaged by a casualty, it ceases to function for its intended purpose of transmitting power and is taken out of service and restored to operation, as a unit. Similarly, if Taxpayer determined the before-and-after value of its damaged property by appraisal, rather than by the cost of repairs method, attempting to appraise the reduction in value of each retirement unit might not take into account, for example, the manner in which a collection of such units comprising a transmission line work in tandem to transmit power from one point to another, and the fact that the line's value resides in its overall condition and its function as a unit. Cf. Rinaldi. In our view, these factors outweigh the possible benefits of using each individual retirement unit as a "single, identifiable property." The purpose of the regulation is not to "squeeze the deduction down to the smallest conceivable molecule of the taxpayer's venture, but rather to allow a loss that is reasonable and bona fide." Weyerhaeuser, 32 Fed. Cl. at 104 (1994).

Each line, circuit, and substation as a "single, identifiable property"

On the facts of this case, we conclude that the examination team's alternative position provides a reasonable basis on which to assess and quantify Taxpayer's casualty losses. While some factors favor this alternative more than other factors, on balance we believe that this is the best approach. Many of the reasons for selecting this approach have been addressed or touched on earlier in this discussion. We summarize and expand on those reasons here.

Reasonable in relation to the nature and scope of the casualty

In our view, use of each line, circuit, and substation as a "single, identifiable property"

strikes a reasonable balance between the large aggregations urged by Taxpayer, and the individual retirement unit or asset submitted by the examination team as its primary position. Under this intermediate approach, there is a correspondence between the areas and functions affected by the casualty and the units used to measure the effect of the casualty for tax purpose. Lines and circuits are identifiable units that cover a discrete geographical area, and have easily identifiable beginning and ending points. The number of lines, circuits and substations included in determining the basis limitation increases with the size of the casualty. This assures that the amount of Taxpayer's property included in determining the basis limitation is reasonable, regardless of the size of the casualty, and regardless of the overall size of a particular taxpayer's entire T&D system. Under this approach, Taxpayer is not permitted to "borrow" basis from—and effectively accelerate cost recovery on—distant, untouched assets. On the other hand, the unit of property is not so small that it is onerous to apply, or distorts the valuation process by excluding elements of the reduction in value caused by the physical damage to Taxpayer's assets.

Functional, operational, and management factors

We believe the field has made the case that in this situation, each line, circuit, and substation can be considered a unit that performs a discrete, identifiable function.

The function of each transmission line is to carry electrical power, at a higher voltage, over longer distances from a generating station to a transmission substation; from one transmission substation to another; or from one transmission substation to a distribution substation. Each transmission line has a starting point, and an ending point, and carries electricity through a specific area.

The function of each distribution circuit is to deliver electrical power from the local substation to the end users. Each circuit provides electricity to a specific group of customers within a specific geographic area.

For both transmission and distribution, substations provide a switching function, convert voltage, and provide a method of disconnecting lines or circuits from the electrical system for maintenance or repair.

This division of Taxpayer's assets is reflected in the way a casualty affects Taxpayer's operations and its recovery efforts. After a casualty event, circuit breakers and reclosers automatically shut down and isolate damaged lines or circuits, for safety and to protect the system. The line or circuit is repaired and then re-energized as a unit. Undamaged lines or circuits generally continue to function. Extra capacity is built into the system, and another line or circuit is often able to provide power temporarily until the damaged line or circuit is placed back in service.

Lines, circuits, and substations are numbered and identified for operational purposes. Taxpayer tracks, records, and reports maintenance, outage history, capacity rating, and reliability down to the level of the individual transmission line and distribution circuit, reports on this basis to regional and state authorities, and structures its maintenance system to address reliability and performance on a circuit-by-circuit basis.

Taxpayer's operations are managed at different levels, as discussed earlier. A single line, circuit, or substation is not a "management unit," as such. However, no one factor is dispositive in the § 165 determination and, as discussed above, each line, circuit, and substation is managed for operational purposes as a discrete functional unit.

Commercially segmentable

Neither Taxpayer nor the industry acquires or sells assets in one uniform grouping. As discussed above, individual assets or retirement units would not normally be sold individually or in bulk, except as scrap, and could not be considered as a commercial or economic unit in Taxpayer's business. However, in addition to acquiring or selling entire T&D systems, Taxpayer has acquired transmission lines and distribution circuits from other utilities or towns in the past. Thus, the line or circuit can be considered a commercially segmentable unit.

Consistent with tax accounting practices

Taxpayer places significant stress on this factor, arguing that since it does not assign a specific basis to each asset, it would be difficult or onerous to require it to determine the basis allocable to individual lines, circuits, or substations, since it cannot simply group and sum the bases of the assets comprising those units. We acknowledge the concerns of the courts that have considered this issue, to the effect that the "single, identifiable property" rule should be applied in a reasonable and practical manner. However, we believe that the rule does not require Taxpayer to determine the precise basis of each line, circuit, and substation, and that Taxpayer, working with the field, should be able to arrive at a reasonable allocation of basis. As noted earlier, unlike the assets at issue in the timber cases, Taxpayer's assets are not growing organisms, and regardless of the depreciation rules that apply to Taxpayer's specific situation, it is clear that the use of multiple-asset depreciation accounts does not prevent the allocation of basis to the specific assets or properties affected by a casualty in order to deduct a casualty loss.

For the foregoing reasons, we conclude that use of the line, circuit, and substation as the "single, identifiable property" damaged or destroyed by the Year 1 and Year 2 storms is a reasonable method of quantifying Taxpayer's casualty loss deduction under § 165. [12]

[12] Arguably, portions of Taxpayer's system could be further segmented into smaller units. The definitions used for network assets in the Class Life Asset Depreciation Range (CLADR) regulations, for example,

CAVEAT:

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

---

adopt a stricter "point-to-point" approach. See § 1.167(a)-11(d)(2)(vi) ("the unit of property for transmission and distribution property consists of each segment which performs a discrete function either as to capacity, service, transmission or distribution between identifiable points"). However, this alternative was not proposed or briefed by the parties; in any case, given the specific language and function of § 1.165-7(b), we do not believe that the unit of property for purposes of calculating a casualty loss is necessarily the same as the unit of property for another tax purpose.