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LEGEND

Taxpayer =
Corporation =
Sub 1 =
Sub 2 =
Entity =
Agency2 =
Department =
Facilities =
Pilot1 =
Pilot2 =
Year1 =
B =
C =
D =
E =
F =
G =
H =

J =
K =
M =
N =
O =
P =
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Dear :

This is in reply to Taxpayer's request for rulings regarding N it will install at the property of certain of its customers pursuant to two pilot programs. Specifically, Taxpayer has requested the following rulings:

- N[1] are ten-year property for purposes of computing the depreciation allowance under § 167 of the Internal Revenue Code;
- N constitute qualified alternative fuel vehicle refueling property under § 30C;
- The grant from Entity to Sub2 is a contribution to capital under § 118; and
- Taxpayer does not have any information reporting obligation under § 6041 with respect to customers participating in the pilot programs due to the installation or

[1] For purposes of this letter, N means either the singular or the plural as appropriate to the context.

transfer of N to those customers because such installation or transfer does not result in gross income to such customers.

FACTS

Taxpayer is the parent of an affiliated group of corporations, including Corporation, Sub1, and Sub2 engaged in J.[2] Taxpayer files a consolidated federal income tax return on a calendar year basis using the accrual method of accounting. Sub1, a wholly owned subsidiary of Taxpayer provides K to customers in B. Sub2, a wholly owned subsidiary of Corporation (which is a wholly owned subsidiary of Taxpayer) provides K to customers in C.

During Year1, Taxpayer expects its customers in B and C to begin taking delivery of D. Taxpayer anticipates that an increase in its customers' use of D will require it to S.

Users of D will need to E, and will be able to do so with F (which they already have) or with G. G allows users of D to E more quickly because it allows for H. N are Gs that in addition to enabling H, also enable Taxpayer to engage in, for example, X.

Taxpayer believes that the use of N will mitigate disruptions to its systems by better managing the increased demand for K, and enable it to reduce the amount of costly future expenses for upgrades to infrastructure and the need to build R. Therefore, during Year1, Sub1 and Sub2 (through a collaborative effort including Agency2 and Entity) each began a pilot program, (Pilot1 and Pilot 2, respectively) under which each will provide N to certain of its customers.

The pilot programs are intended to enable Taxpayer to gather data, monitor customer usage patterns, and assess certain impacts of N. The goal of Sub1's program is to evaluate U. Sub1 believes that the results of its pilot program will assist it in planning for the increase in D in a way that will lessen its costs. The goal of Sub2's project is also to evaluate U. Sub2 anticipates that its project will help it understand the impact of D on its business and the technical capabilities of N.

Both pilot programs will provide N to residential customers in those locations who meet certain criteria. Sub1's pilot program is not available to employees of Taxpayer, Sub1 or their affiliates. Sub2, however, expects to make N available for use to some commercial or public customers as well as a few of its own employees.

Participating customers must meet certain requirements, such as owning the property where N are used, having a suitable location for installation of N, and owning or leasing a M.

[2] For purposes of this ruling, we may use the term "Taxpayer" when referring to the activities of one or more of Taxpayer, Sub1, Sub2, and Corporation.

The pilot programs require customers to agree to participate for a minimum of y from the date that N are installed on their property. Customers must grant access to their property to allow Sub1 and Sub2 to maintain, replace, or repair N. Customers must also permit Sub1 and Sub2 to gather information from N to evaluate the impact of D on the use of K.

At all times during the term of the agreement for Pilot1, Sub1 will retain title to N. Sub1 will maintain N during the term of the agreement and make any necessary repairs at its expense. During Pilot1, Sub1 retains the benefits and burdens of ownership of N.

At all times during the term of the agreement of Pilot2, Sub2 will retain title to N. Sub2 will maintain N during the term of the agreement and make any necessary repairs at its expense. During the term of Pilot2, Sub2 retains the benefits and burdens of ownership of N.

Residential customers of Sub1 may purchase an N from Sub1 for $w at the end of the term of the agreement with Sub1. Sub1 will remove the N if its customer does not purchase it. Sub2 will transfer ownership of an N to a customer for $t at the end of the term of the agreement with its customers. Sub2 will remove the N at the end of the agreement if the customer does not want it.

N rely on O to communicate with Taxpayer. The technology not only allows N to send data regarding T to Taxpayer but also allows Taxpayer to program N to W and enables Taxpayer to BB.

N is installed at a residential customer's home as follows. An EE line runs from Taxpayer's CC to the V at the customer's home. The V is connected to the Z in the customer's home. The Z generally is where all of the DD for the home are located. The N will be wired into the Z (or a GG in some cases) in the customer's home. Thus, the N is on the Y, like FF in the customer's home. The K used by N is measured by the V in the same way that the K supplied to HH in the home would be measured. At all times after the installation, N will be physically connected to the Z, which is connected to the V at the customer's home (i.e., N will be located on Y).

Taxpayer will utilize KK manufactured by LL (the "NN") for the pilot programs. In the event that Taxpayer installs a different N pursuant to the pilot programs, such N shall not materially differ from the NN.

Department awarded Agency2 a grant to purchase N. Entity is administering the grant for Agency2. Sub2 will purchase the N that it installs on customers' premises under the pilot program. Sub2 will be reimbursed by Entity for the cost of N installed during the pilot program in C.

LAW AND ANALYSIS

Section 167 – Depreciation

Section 167(a) provides that there is allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business or held for the production of income.

The depreciation deduction provided by § 167(a) for tangible property placed in service after 1986 generally is determined under § 168. This section prescribes two methods of accounting for determining depreciation allowances: (1) the general depreciation system in § 168(a); and (2) the alternative depreciation system in § 168(g). Under either depreciation system, a taxpayer computes the depreciation deduction by using a prescribed depreciation method, recovery period, and convention.

For purposes of § 168, the classification of property under § 168(e) is determined by reference to class life or by statute. Pursuant to § 168(e)(1), property with a class life of 4 years or less is classified as 3-year property, property with a class life of more than 4 years but less than 10 years is classified as 5-year property, property with a class life of 10 years or more but less than 16 years is classified as 7-year property, property with a class life of 16 years or more but less than 20 years is classified as 10-year property, property with a class life of 20 years or more but less than 25 years is classified as 15-year property, and property with a class life of 25 years or more is classified as 20-year property.

Section 168(i)(1) defines the term "class life" as meaning the class life (if any) that would be applicable with respect to any property as of January 1, 1986, under § 167(m) (determined without regard to § 167(m)(4) and as if the taxpayer had made an election under § 167(m)) as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990. Former § 167(m) provided that in the case of a taxpayer who elected the asset depreciation range (ADR) system of depreciation, the depreciation allowance was based on the class life prescribed by the Secretary that reasonably reflected the anticipated useful life of that class of property to the industry or other group.

Section 1.167(a)-11(b)(4)(iii)(*b*) of the Income Tax Regulations provides rules for classifying property under former § 167(m). Property is included in the asset guideline class for the activity in which the property is primarily used. Further, property is classified according to primary use even though the activity in which such property is primarily used is insubstantial in relation to all the taxpayer's activities. Section 1.167(a)-11(e)(3)(iii) further provides that in the case of a lessor of property, unless there is an asset guideline class in effect for lessors of such property, the asset

guideline class for the property is determined as if the property were owned by the lessee. However, in the case of an asset guideline class based upon the type of property (for example, trucks or railroad cars) as distinguished from the activity in which used, the property is classified without regard to the activity of the lessee.

Rev. Proc. 87-56, 1987-2 C.B. 674, sets forth the class lives of property subject to depreciation under § 168. This revenue procedure divides assets into two broad categories: (1) asset classes 00.11 through 00.4 that consist of specific depreciable assets used in all business activities; and (2) asset classes 01.1 through 80.0 that consist of depreciable assets used in specific business activities. An asset that falls within both an asset group (that is, asset classes 00.11 through 00.4) and an activity group (that is, asset classes 01.1 through 80.0) would be classified in the asset group. See *Norwest Corp. & Subs. v. Commissioner*, 111 T.C. 105, 156-64 (1998). Several appellate decisions discuss the "primary use" standard for asset classification under § 1.167(a)-11(b)(4)(ii)(*b*). See, e.g., *Clajon Gas Co, L.P. v. Commissioner*, 354 F. 3d 786 (8th Cir. 2004). Courts have concluded that the actual purpose and function of an asset determines its asset class (a use-driven functional standard) rather than the terminology used to describe an asset by its owners or others.

Section 306 of Division B of the Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008), amended § 168 by adding §§ 168(e)(3)(D)(iv) and 168(i)(19). Both sections are effective for property placed in service after October 3, 2008.

Section 168(e)(3)(D)(iv) provides that any qualified smart electric grid system is 10-year property.

Section 168(i)(19)(A) defines the term "qualified smart electric grid system" as meaning any smart grid property that (i) is used as part of a system for electric distribution grid communications, monitoring, and management placed in service by a taxpayer who is a supplier of electric energy or a provider of electric energy services, and (ii) does not have a class life (determined without regard to § 168(e)) of less than 10 years.

For purposes of § 168(i)(19)(A), § 168(i)(19)(B) defines the term "smart grid property" as meaning electronics and related equipment that is capable of (i) sensing, collecting, and monitoring data of or from all portions of a utility's electric distribution grid, (ii) providing real-time, two-way communications to monitor or manage such grid, and (iii) providing real time analysis of and event prediction based upon collected data that can be used to improve electric distribution system reliability, quality, and performance.

If there is not an asset class of Rev. Proc. 87-56 that describes the property or the business activity in which the property is primarily used and if the property is not

otherwise classified under § 168(e)(2) or (3), the property is 7-year property pursuant to § 168(e)(3)(C)(v).

Even if the N is smart grid property under § 168(i)(19)(B), the N is not a qualified smart electric grid system under § 168(i)(19)(A) if the N has a class life of less than 10 years. Thus, the issue is whether there is an asset class of Rev. Proc. 87-56 that describes Taxpayer's business activity in which the N is used by Taxpayer.

Taxpayer's business activity as it relates to Taxpayer's use of the N is to conduct two pilot programs to study the impact of D on customer demand for K in Taxpayer's RR by providing the N to certain customers in order to gather data related to the customers' use of the N in TT.

There are two asset classes that may apply to Taxpayer's business activity as it relates to its use of N: asset class 49.14, Electric Utility Transmission and Distribution Plant, or asset class 57.0, Distributive Trades and Services.

Asset class 49.14 of Rev. Proc. 87-56 includes assets used in the transmission and distribution of electricity for sale and related land improvements. This class excludes initial clearing and grading land improvements as specified in Rev. Rul. 72-403, 1972-2 C.B. 102. Assets in this class have a class life of 30 years and, as a result, are classified as 20-year property under § 168(e)(1).

The Tax Court in *PPL Corporation v. Commissioner*, 135 T.C. 176 (2010), concluded that street light assets are not assets used in the distribution of electricity and, thus, not included in asset class 49.14 of Rev. Proc. 87-56. In reaching its conclusion, the Court looked at the definition of the word "distribution" as well as the primary use of the street light assets. The parties stipulated that distribution meant "the delivery of electric energy to customers" and "the final utility step in the provision of electric service to customers." The Court found this definition to be consistent with a standard definition of distribution. 135 T.C. at 183. The Court also stated that the "distribution of electricity seems to us to be the process by which electricity (the commodity) gets to final consumers." *Id*. The Court found that street light assets could be disconnected from the distribution system without effecting electrical distribution to customers and they are distinct from distribution assets because they have a different purpose and function. On this last point, the Court found that distribution assets get final consumers electricity, service drops are the final part of the distribution of electricity to final consumers, and street light assets are not part of the service to get electricity to final consumers.

In this case, Taxpayer represents that the N is located on the Y. Essentially, an EE connects an CC (which is a part of Taxpayer's UU) to a V at the customer's home and the V, in turn, is connected to the Z, which is generally where all of the DD for the home are located. The N will be wired into the Z. Thus, the N is located on the Y, like FF in

the customer's home. The V measures the K being used by the N and supplied to HH in the home.

Because the N is physically located on the Y, like WW, we do not view the N as a part of Taxpayer's XX. Thus, Taxpayer's business activity of conducting pilot programs to study the impact of D on customer demand for K by providing N to certain customers who are participants in the programs does not involve the transmission and distribution of electricity for sale and, consequently, is not described in asset class 49.14.

Asset class 57.0 of Rev. Proc. 87-56 includes assets used in wholesale and retail trade, and personal and professional services. Assets in this class have a class life of 9 years and, as a result, are classified as 5-year property under § 168(e)(1).

Under Taxpayer's facts, Taxpayer is not in either a wholesale trade or retail trade activity that involves the leasing of N to its customers. Instead, Taxpayer's business activity involves conducting pilot programs to study the impact of D on customer demand for K by providing N to certain customers who are participants in the programs. Thus, Taxpayer's business activity, as described above, does not involve N being used in either a wholesale trade or retail trade activity and, consequently, is not described in asset class 57.0.

Consequently, there is not an asset class of Rev. Proc. 87-56 that describes Taxpayer's business activity of conducting pilot programs to study the impact of D on customer demand for K by providing N to certain customers who are participants in the programs. Accordingly, N do not have a class life.

For purposes of § 168(i)(19)(A)(ii), we view property with a class life of less than 10 years as encompassing property with no class life. Thus, the N are not classified as a qualified smart electric grid system under § 168(e)(3)(D)(iv).

Section 30C – Alternative Fuel Vehicle Refueling Property Credit

Section 30C(a) provides a credit in the amount of 30 percent of the cost of any qualified alternative fuel vehicle refueling property placed in service by the taxpayer during the taxable year.

Section 30C(b) provides that the credit allowed under § 30C(a) with respect to all qualified alternative fuel vehicle refueling property placed in service by the taxpayer during the taxable year at a location shall not exceed $30,000 in the case of a property of a character subject to an allowance for depreciation, and $1,000 in any other case.

Section 30C(c) provides that the term "qualified alternative fuel vehicle refueling property" for purposes of § 30C has the same meaning as the term "qualified clean-fuel

vehicle refueling property" under § 179A, but only with respect to the alternative fuels listed in § 30C(c)(2). Section 30C(c)(2)(C) lists electricity as a qualified fuel.

Under § 179A(d), “qualified clean-fuel vehicle refueling property” means property that is subject to depreciation, the original use of which begins with the taxpayer, and that is for the recharging of motor vehicles propelled by electricity, but only if the property is located at the point where the motor vehicles are recharged. Section 179A(e)(2) provides that a motor vehicle is any vehicle that is manufactured primarily for use on public streets, roads, and highways (not including a vehicle operated exclusively on a rail or rails) and that has at least four wheels.

Pursuant to § 30C(d), the credit for alternative fuel vehicle refueling property that is property of a character subject to an allowance for depreciation is treated as part of the general business credit under § 38(b) for the taxable year (and not allowed under § 30C(a)).

Section 30C(e)(1) provides that the basis of any property shall be reduced by the portion of the cost of such property taken into account under § 30C(a).

Section 30C(g)(2) provides that § 30C does not apply to property placed in service after December 31, 2011.

Taxpayer represents that N are of a character subject to the allowance for depreciation, that the original use of N begins with Taxpayer, and that N are for P, and are located at the point where Q. Taxpayer’s N meet the requirements of § 30C.

Section 118 – Contributions to the Capital of a Corporation

Section 118(a) provides that in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Section 1.118-1 provides, in part, that § 118 also applies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of enabling the corporation to expand its operating facilities. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid to induce the taxpayer to limit production.

The legislative history to § 118 indicates that the exclusion from gross income for nonshareholder contributions to capital of a corporation was intended to apply to those contributions that are neither gifts, because the contributor expects to derive indirect benefits, nor payments for future services, because the anticipated future benefits are too intangible. The legislative history also indicates that the provision was intended to

codify the existing law that had developed through administrative and court decisions on the subject. H.R. Rep. No. 83-1337 at 17 (1954); S. Rep. No. 83-1622 at 18-19 (1954).

The legislative history of § 118 provides, in part, as follows:

> This [§ 118] in effect places in the Code the court decisions on the subject. It deals with cases where a contribution is made to a corporation by a governmental unit, chamber of commerce, or other association of individuals having no proprietary interest in the corporation. In many such cases because the contributor expects to derive indirect benefits, the contribution cannot be called a gift; yet the anticipated future benefits may also be so intangible as to not warrant treating the contribution as a payment for future services.

S. Rep. No. 83-1622 at 18-19 (1954).

In *Detroit Edison Co. v. Commissioner*, 319 U.S. 98 (1943), the Court held that payments by prospective customers to an electric utility company to cover the cost of extending the utility's facilities to their homes, were part of the price of service rather than contributions to capital. The case concerned customers' payments to a utility company for the estimated cost of constructing service facilities (primary power lines) that the utility company otherwise was not obligated to provide. The customers intended no contribution to the company's capital.

Later, in *Brown Shoe Co. v. Commissioner*, 339 U.S. 583 (1950), the Court held that money and property contributions by community groups to induce a shoe company to locate or expand its factory operations in the contributing communities were nonshareholder contributions to capital. The Court reasoned that when the motivation of the contributors is to benefit the community at large and the contributors do not anticipate any direct benefit from their contributions, the contributions are nonshareholder contributions to capital. *Id*. at 591.

The Court in *United States v. Chicago, Burlington & Quincy Railroad Co.*, 412 U.S. 401 (1973), explained its decisions in *Detroit Edison* and *Brown Shoe*. The decisional distinction between *Detroit Edison* and *Brown Shoe* rested upon the nature of the benefit to the transferor, rather than to the transferee, and upon whether that benefit was direct or indirect, specific or general, certain or speculative. Where the transfers were made with the purpose, not of receiving direct service or recompense as in *Detroit Edison*, but of obtaining advantage for the general community as in *Brown Shoe*, the result is a contribution to capital.

In addition, the Court stated that other characteristics of a contribution to capital are implicit in the two cases that do focus upon the use to which the assets transferred were applied or upon the economic and business consequences for the transferee

corporation. The Court listed the following characteristics of a nonshareholder contribution to capital:

> [1] It certainly must become a permanent part of the transferee's working capital structure. [2] It may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee. [3] It must be bargained for. [4] The asset transferred foreseeably must result in benefit to the transferee in an amount commensurate with its value. [5] And the asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect.

Id. at 413.

In the present case, all the requirements of *Chicago, Burlington, & Quincy Railroad* have not been met.

Section 6041 – Information at Source

Section 6041 requires all persons engaged in a trade or business who, in the course of that trade or business, pay another person "fixed and determinable gains, profits, and income" aggregating $600 or more in any taxable year to (1) file an information return for each calendar year in which they make such payments and (2) furnish a copy of the information return to that person. *See* § 6041(a) and (d) and Treas. Reg. § 1.6041-1(a)(1) and (b). Although the word "income" as used in § 6041 is not defined by statute or regulation, its appearance in the phrase "fixed or determinable gains, profits, and income" indicates that it refers to "gross income," not the gross amount paid. Thus, § 6041 requires you to report only those payments in excess of $600 that are includible in a recipient's gross income.

Under § 61(a) gross income means all income from whatever source derived. Gross income extends to undeniable accessions to wealth, clearly realized, over which the taxpayers have complete dominion. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955).

Our view is that Taxpayer's Pilot1 and Pilot2 are for its benefit. For example, under the programs, Taxpayer will (1) monitor customer behavior when they E, (2) program N to operate when the demand for K is reduced, (3) base billing on data collected from N. In addition, as a result of the programs, Taxpayer will be able to manage the increased demand for K attributable to D more efficiently, thereby mitigating disruptions, and reducing the need for costly upgrades to Taxpayer's major assets. Moreover, participating customers do not need N to E because they are already able to do so with F. Under these and all of the other facts of Pilot1 and Pilot2, neither the installation of N at Taxpayer's customers' properties under the pilot programs nor the transfer of N to the

customers at the termination of the programs gives rise to income to the customers under § 61. Since there is no income under § 61, Taxpayer does not have any information reporting obligation under § 6041 with respect to the customers for such installations or transfers.

CONCLUSIONS

Based strictly on the information submitted, representations made, and the relevant law and analysis set forth above we conclude that—

- To the extent that N are tangible depreciable property used in Taxpayer's business activity of conducting pilot programs to study the impact of D on customer demand for K by providing N to certain customers who are participants in the programs, N do not have a class life, are not classified under § 168(e)(2), and are not otherwise classified under § 168(e)(3) and, thus, such property used in such business activity is 7-year property pursuant to § 168(e)(3)(C)(v) .
- N will constitute qualified alternative fuel vehicle refueling property under § 30C, provided that Taxpayer places them in service on or before December 31, 2011, or a subsequent date if the credit is extended;
- Payments from Entity to Sub2 for N are not a nonshareholder contribution to the capital of Sub2 under § 118(a); and
- Taxpayer, Sub1, Corporation, and Sub2 do not have any information reporting obligation under § 6041 with respect to customers under Pilot1 and Pilot2 for installations of N at their customers' properties or transfers to their customers of N.

We do not express or imply an opinion on the federal tax consequences of any aspect of these transactions other than those expressed above. For example, we do not express or imply any opinion (i) whether Sub2 has any obligations under subtitle C, § 6041, or § 6051 from Sub2's leasing Ds or providing N to its employees, (ii) whether Sub2 has any information reporting obligations under § 6041 for Gs provided to Agency2 at Facilities, or (iii) on the classification of Gs installed by Sub2 at Facilities under § 168(e).

This letter ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations that Taxpayer submitted under penalties of perjury. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Taxpayer must attach to any income tax return to which it is relevant a copy of this letter or, if it files its returns electronically, include a statement providing the date and control number of this letter ruling.

In accordance with the Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Sincerely,

Michael J. Montemurro
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)