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Person To Contact:
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TY:

LEGEND:

Taxpayer =
Year 1 =
Year 2 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
New Turnpike =
Route 1 =

State X =
State Y =
Authority =

Dear

This responds to your request for a private letter ruling, dated May 22, 2012, regarding the application of § 1033 of the Internal Revenue Code to payments received for removing and relocating utility equipment, as required by the Authority (the condemning authority).

FACTS:

Taxpayer, a State X limited liability company, is a public utility engaged in the business of electricity transmission and distribution in State Y. Taxpayer uses the annual accounting period ending December 31 and the overall accrual method of accounting.

Authority, a political subdivision of State Y, builds and operates turnpikes. It may use eminent domain to acquire real property that it determines necessary and appropriate to construct and efficiently operate turnpikes. If Authority determines that relocation of a public utility facility is necessary, the owner-operator of the facility must, by law, relocate or remove the facility in accordance with the requirements of Authority, in a manner that does not impede the design, financing, construction, operation, or maintenance of a turnpike project. Authority must pay the cost of the relocation or removal.

In Year 1, Authority notified Taxpayer that it intended to construct New Turnpike along Route 1 and that some of Taxpayer's electricity transmission structures infringed on the New Turnpike right of way.[1] Authority ordered Taxpayer to relocate the infringing facilities to accommodate the construction of New Turnpike, and they set a schedule for the removal and relocation to be completed by Date 3. In Year 2, Taxpayer began the engineering and design process necessary for the relocation.

When Authority requires Taxpayer to relocate a utility facility, the standard practice is for Taxpayer to pay the expenses of the relocation and seek reimbursement after relocation occurs. Taxpayer followed the standard procedure for this relocation project. Because Taxpayer provided the initial funding, Taxpayer did not begin the relocation until the relevant government agencies reviewed the scope of the work necessary and agreed to reimburse the relocation expenditures. Thus, during Year 2, Taxpayer submitted its costs estimates to tear down, relocate and install new utility facilities. On Date 1, Authority agreed to the scope of the work and cost estimates and authorized the project. Authority agreed to reimburse only actual expenses reduced by the salvage value of any existing materials, the cost of "betterments," and a credit for extended service life. Taxpayer completed the relocation project on Date 2, ahead of schedule. On or about Date 4, Authority sent Taxpayer a check in full reimbursement of its relocation costs for this project.

APPLICABLE LAW & ANALYSIS:

Section 1033(a)(2)(A) generally provides that if property is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, and if the taxpayer –

(i) during the replacement period specified in subparagraph (B),
(ii) for the purpose of replacing the property so converted,
(iii) purchases other property similar or related in service or use to the property so converted,

[1] The land which Authority's turnpike occupies is owned by Authority. Authority grants right-of-ways at no cost to Taxpayer as needed for Taxpayer's placement of its electric utility facilities.

then, at the election of the taxpayer, the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property.

Section 1033(a)(2)(B) generally provides that the replacement period referred to in subparagraph (A) shall be the period beginning with the date of the earlier of the disposition of the converted property, or the threat or imminence of requisition or condemnation of the converted property, and ending 2 years after the close of the first taxable year in which any part of the gain upon the conversion is realized.

In Rev. Rul. 58-396, 1958-2 C.B. 403, a taxpayer's residence was condemned to make way for a highway. Under the terms of the condemnation award, in addition to receiving money, the taxpayer was permitted to remove the residence from the condemned property to a lot purchased by the taxpayer following the condemnation. The taxpayer also purchased a second residential property with the proceeds of the condemnation. The cost of the new properties plus the cost of moving the house from the condemned property to one of the new properties exceeded the monetary award received by the taxpayer. Rev. Rul. 58-396 holds that the costs incurred in purchasing the new properties and moving the old house to one of the new properties constitute a replacement, within the meaning of § 1033, of the property involuntarily converted. Thus, because the cost of the replacement property, including the cost of moving the old residence to the new property, exceeded the condemnation award, full deferral of gain was permitted.

In *Graphic Press, Inc. v. Commissioner*, 523 F.2d 585 (9th Cir. 1975), the Court held that a condemnation award that included the cost of moving heavy equipment qualified for deferral under § 1033. There, the California Department of Public Works notified the taxpayer that the State of California intended to condemn the Taxpayer's property in connection with the widening of the San Bernardino Freeway. The State condemned the taxpayer's land, building and fixtures, including machinery. As part of its rationale for concluding that the compensation for moving costs qualified, the Court stated:

> Section 1033 is a relief provision. Its purpose is "to aid the taxpayer where he in good faith quickly transforms everything he received into property 'similar or related in … use.'" *Commissioner v. Babcock,* 259 F.2d 689, 692 (9th Cir. 1958) (interpreting predecessor to § 1033). *See also, Winter Realty & Construction Co. v. Commissioner*, 149 F.2d 567, 569-70 (2d Cir.), *Cert. denied* 326 U.S. 754(1945). . . .
>
> We believe compensation in excess of land and building payments in this case qualifies for § 1033 treatment. From the taxpayer's viewpoint, he is being compensated for a loss due to the condemnation of his property. Whatever payment the taxpayer receives is attributable to the involuntary conversion.

> Where, as here, a payment is made for relocation costs in addition to land costs, as long as Taxpayer reinvests the total award into other property similar or related in service or use within the statutory period, both the language and spirit of the statute are met.

*Graphic Press, 5*23 F.2d at 589.

As in *Graphic Press*, the present case involves a conversion that includes an award for removal and relocation costs. Taxpayer will use the proceeds from the conversion to achieve the same economic position it enjoyed before with respect to the affected property. In the present case, the language and spirit of the statute are met because the form, nature or use of Taxpayer's business property resulting from the conversion and reinvestment will remain substantially the same.

RULING:

Taxpayer may elect to defer gain under § 1033 on payments it receives for removing and relocating utility equipment as required by Authority, provided the amounts received are reinvested in other property similar or related in service or use to the property converted and for removal and relocation of affected property or equipment within the replacement period under § 1033(a)(2)(B).

CAVEATS:

The above ruling is conditioned on Taxpayer neither deducting nor capitalizing the removal and relocation costs incurred by Taxpayer to the extent such costs are attributable to reimbursement amounts received from Authority. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative(s).

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The ruling contained in this letter is based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by

an appropriate party. 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.

Sincerely,

Christina M. Glendening
Assistant to the Branch Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: