**Internal Revenue Service**

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B06
PLR-136207-15

Date:
February 9, 2016

LEGEND:

Taxpayer =

Parent =

State A =
State B =
Commission A =
Commission B =
Commission C =
A =
B =
C =
Date A =
Year A =
X =
Y =
Facility A =
Facility B =

Facility C =

Director =

Dear :

This letter responds to your representative's request dated October 30, 2015, for a ruling on whether the Facility described below is classified as public utility property within the meaning of former section 46(f), § 168(i)(10), and the regulations promulgated thereunder for purposes of the application of the normalization rules to that Facility.

The representations set out in your letter follow.

Taxpayer, a wholly-owned subsidiary of Parent, is a public utility primarily engaged in the business of generating, transmitting, distributing, and selling electric power to customers in State A and State B. It is subject to regulation by Commission A, Commission B, and Commission C with respect to terms and conditions of services, including the rates it may charge for its services. Commission A and Commission B generally establish Taxpayer's rates based on Taxpayer's costs, including a provision for a return on the capital employed by Taxpayer in its regulated business. To the extent Taxpayer's sales are under the jurisdiction of Commission C, its rates are established through negotiation and/or by the wholesale market. Finally, approximately B percent of Taxpayer's load is used to provide electricity to certain non-jurisdictional retail customers, generally governmental entities located in State A. The rates for the non-jurisdictional customers are established by means of bi-lateral negotiations between Taxpayer and the customer rather than as tariffs established by regulatory authorities.

State A law allows a stand-alone ratemaking proceeding for utilities within their jurisdiction to recover their cost for certain types of facilities, including those generating electricity through the use of solar energy. Under this provision, the utility may propose to Commission A the recovery of its costs based on a market index rather than a more traditional cost of service model. Taxpayer developed a plan to build or acquire several solar energy facilities, intending to use the stand-alone ratemaking proceeding to recover its costs. In Year A Taxpayer solicited power purchase agreement proposals to acquire approximately X megawatts of electricity generated by solar facilities located within State A. Using the proposals received, Taxpayer developed a market index, which Taxpayer has proposed to Commission A, providing for a rate of $Y per megawatt hour for the electricity produced at the solar facilities. The stand-alone ratemaking will also provide an annual true-up, but such true-up will not include differences between projected and actual costs, as would be the case if the ratemaking were based on a traditional cost of service methodology. .

On Date A, Taxpayer filed an application with Commission A for a certificate of public and necessity allowing construction of Facility A, Facility B, and Facility C (the Facilities), as well as its request for approval of Taxpayer's proposed market index to recover the cost of the Facilities. If Commission A approves the applications as filed, Taxpayer will construct the Facilities. The energy produced by the facilities will be allocated approximately as follows: A percent to customers within the jurisdiction of

Commission A, B percent to non-jurisdictional customers, and C percent to customers under the jurisdiction of Commission C.

Taxpayer requests that we rule as follows:

(1) Assuming Commission A adopts Taxpayer's Market Index rate adjustment clause proposal, that portion of the three Facilities subject to the jurisdiction of Commission A will not constitute "public utility property" within the meaning of former section 46(f), § 168(i)(10), and the regulations promulgated thereunder.

(2) That portion of the three Facilities that serves the non-jurisdictional retail customers in State A will not constitute "public utility property" within the meaning of former section 46(f), § 168(i)(10), and the regulations promulgated thereunder.

(3) That portion of the three Facilities that serves Commission C wholesale customers will not constitute "public utility property" within the meaning of former section 46(f), § 168(i)(10), and the regulations promulgated thereunder.

Law and Analysis

Section 168(f)(2) of the Code provides that the depreciation deduction determined under § 168 shall not apply to any public utility property (within the meaning of § 168(i)(10)) if the taxpayer does not use a normalization method of accounting.

Section 168(i)(10) of the Code defines, in part, public utility property as property used predominantly in the trade or business of the furnishing or sale of electrical energy if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof.

Prior to the Revenue Reconciliation Act of 1990, the definition of public utility property was contained in § 167(l)(3)(A) and § 168(i)(10), which defined public utility property by means of a cross reference to § 167(l)(3)(A). The definition of public utility property is unchanged. Section 1.167(l)-1(b) provides that under § 167(l)(3)(A), property is public utility property during any period in which it is used predominantly in a § 167(l) public utility activity. The term "section 167(l) public utility activity" means, in part, the trade or business of the furnishing or sale of electrical energy if the rates for such furnishing or sale, as the case may be, are regulated, i.e., have been established or approved by a regulatory body described in § 167(l)(3)(A). The term "regulatory body described in section 167(l)(3)(A)" means a State (including the District of Columbia) or political subdivision thereof, any agency or instrumentality of the United States, or a public service or public utility commission or other body of any State or political subdivision thereof similar to such a commission. The term "established or approved" includes the filing of a schedule of rates with a regulatory body which has the power to

approve such rates, though such body has taken no action on the filed schedule or generally leaves undisturbed rates filed by the taxpayer.

The definitions of public utility property contained in § 168(i)(10) and former § 46(f)(5) are essentially identical. Section 1.167(l)-1(b) restates the statutory definition providing that property will be considered public utility property if it is used predominantly in a public utility activity and the rates are regulated. Section 1.167(l)-1(b)(1) provides that rates are regulated for such purposes if they are established or approved by a regulatory body. The terms established or approved are further defined to include the filing of a schedule of rates with the regulatory body which has the power to approve such rates even though the body has taken no action on the filed schedule or generally leaves undisturbed rates filed.

The regulations under former section 46, specifically § 1.46-3(g)(2), contain an expanded definition of regulated rates. This expanded definition embodies the notion of rates established or approved on a rate of return basis. This notion is not specifically provided for in the regulations under former section 167. Nevertheless, there is an expressed reference to rate of return in § 1.167(l)-1(h)(6)(i). The operative rules for normalizing timing differences relating to use of different methods and periods of depreciation are only logical in the context of rate of return regulation. The normalization method, which must be used for public utility property to be eligible for the depreciation allowance available under § 168, is defined in terms of the method the taxpayer uses in computing its tax expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account. Thus, it is clear that, for purposes of application of the normalization rules, the definition of public utility property is the same for purposes of the investment tax credit and depreciation.

Thus, the key factors in determining whether property is public utility property are that (1) the property must be used predominantly in the trade or business of the furnishing or sale of, inter alia, electrical energy; (2) the rates for such furnishing or sale must be established or approved by a State or political subdivision thereof, any agency or instrumentality of the United States, or by a public service or public utility commission or similar body of any State or political subdivision thereof; and (3) the rates so established or approved must be determined on a rate-of-return basis. As a preliminary matter, the Facilities are all used primarily in the trade or business of furnishing electrical energy, satisfying the first factor. Here, Taxpayer will construct the Facilities and it's costs will be recovered, to the extent relevant here, under three different methodologies.

First, for electricity produced by the Facilities and allocated to customers within the jurisdiction of Commission A, Taxpayer's rates will be determined under a market index approved by Commission A. Those rates are therefore established or approved by a public utility commission, satisfying the second factor. However, because the rates are determined under a market index and not on a rate-of-return basis, the Facilities are

not public utility property to the extent that the energy produced by the Facilities is allocated to customers within the jurisdiction of Commission A.

Second, for electricity produced by the Facilities and allocated to non-jurisdictional customers located within State A, Taxpayer's rates are established by means of bi-lateral negotiations between Taxpayer and the customer rather than as tariffs established by regulatory authorities. Thus, these rates are not established or approved by a public utility commission and are not determined on a rate-of-return basis. Therefore, the Facilities are not public utility property to the extent that the energy produced by the Facilities is allocated to the non-jurisdictional customers within State A.

Third, for electricity produced by the Facilities and allocated to customers within the jurisdiction of Commission C, Taxpayer's rates are established or approved by a public utility commission, satisfying the second factor. However, because the rates are determined through negotiation and/or by the wholesale market index and not on a rate-of-return basis, the Facilities are not public utility property to the extent that the energy produced by the Facilities is allocated to customers within the jurisdiction of Commission C.

Conclusions:

(1) Assuming Commission A adopts Taxpayer's Market Index rate adjustment clause proposal, that portion of the three Facilities subject to the jurisdiction of Commission A will not constitute "public utility property" within the meaning of former section 46(f), § 168(i)(10), and the regulations promulgated thereunder.

(2) That portion of the three Facilities that serves the non-jurisdictional retail customers in State A will not constitute "public utility property" within the meaning of former section 46(f), § 168(i)(10), and the regulations promulgated thereunder.

(3) That portion of the three Facilities that serves Commission C wholesale customers will not constitute "public utility property" within the meaning of former section 46(f), § 168(i)(10), and the regulations promulgated thereunder.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above under any other provisions of the Code (including other subsections of § 168). Specifically, no opinion is expressed concerning whether the contract to sell electricity constitutes a service contract under § 7701(e). In addition, no opinion is expressed concerning whether the Taxpayer is the owner of the Facility generating electricity for federal income tax purposes. Further, no opinion is expressed or implied on the classification of the property under § 168(e). Except as provided in § 168(e)(3), section 5.03 of Rev. Proc. 87-56, 1987-2 C.B. 674, provides, however, that asset classes in Rev. Proc. 87-

56 include property described in such asset classes without regard to whether a taxpayer is a regulated public utility or an unregulated company**.** .

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides 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. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)