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Telephone Number:

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In Re:

Legend:

Taxpayer =

Corp 1 =

Development Company =

Holding Company =

State A =

State B =

State C =

State D =

Regulator 1 =

Regulator 2 =

Year 1 =

Date 1 =

Date 2 =

Date 3 =

Dear :

This letter responds to a request for a private letter ruling dated July 20, 2017, and subsequent correspondence submitted on behalf of Taxpayer for a ruling concerning the application of the normalization rules under § 168(i)(9) of the Internal Revenue Code and § 1.167(l)-1 of the Income Tax Regulations to internal restructurings of certain of its members. The relevant facts as represented in your submissions are set forth below.

FACTS

Taxpayer is an electric transmission utility headquartered in State A, which owns and operates electric transmission assets in State A, State B, State C, and State D. Various investor owned utilities (IOUs), municipalities, and electric cooperatives own Taxpayer. In addition, Corp 1, Taxpayer's corporate manager, owns a de minimis interest in Taxpayer. Regulator 1 regulates Taxpayer for tariffed rates determined under formula ratemaking on a rate base, rate of return basis. Taxpayer's assets are used predominantly in the trade or business of furnishing or selling electrical energy, and the rates that Taxpayer has charged for furnishing or selling electricity have been established or approved by Regulator 1.

Taxpayer is treated as a partnership for federal tax purposes. Taxpayer uses accelerated methods of depreciation and a normalization method of accounting for its public utility property, and has established deferred tax reserves for the public utility property. For ratemaking purposes, Taxpayer calculates deferred tax expense and accumulated deferred federal income tax ("ADFIT") consistent with the normalization method of accounting in accordance with Regulator 1 policy. For ratemaking purposes, deferred tax expense is recovered in Taxpayer's cost of service and ADFIT is an offset to Taxpayer's rate base.

In Year 1, Taxpayer restructured its business. Taxpayer established entities for its business development activities outside its traditional footprint to separate those activities from its operations within its traditional footprint. The business development entities were set up to be a "sister" structure to that of Taxpayer and Corp 1. Prior to the reorganization, all of the operations related to jurisdictions in its traditional footprint were held by Taxpayer. Following the reorganization, all business development activities relating to jurisdictions outside Taxpayer's traditional footprint were held by Development Company. The investors in Taxpayer that participate in Development Company own their interest in Development Company through Holding Company.

When seeking approval for the business development restructuring, Regulator 2 required certain of Taxpayer's IOU members to transfer their Taxpayer partnership interests to affiliated nonregulated entities. To accomplish the Regulator 2 directive, the affected IOU members transferred their respective Taxpayer interests from their regulated utility subsidiaries to non-regulated affiliates. The transfers were made to affiliated entities in the respective members' consolidated federal income tax groups. Taxpayer continues its investment in the public utility property assets reflected on Taxpayer's books. Taxpayer represents that no transfer of Taxpayer assets took place, and no journal entries were recorded in Taxpayer's financial statements for the transfers.

Taxpayer has a § 754 election in effect. The transfers of Taxpayer interests by IOU members to their non-regulated affiliates were treated as "exchanges" for § 743(b) purposes. Thus, Taxpayer made § 743(b) basis adjustments to its assets for the benefit of the transferee partners (the non-regulated affiliates) at the time of the transfers.

An IOU member's gain resulting from the transfer of the Taxpayer interests to the non-regulated affiliates remains deferred for as long as the IOU member's transferred interest remains within its respective consolidated groups. In accordance with the matching rule in § 1.1502-13(c) of the consolidated return regulations, the deferred intercompany gain will be recognized as the Taxpayer allocates to the non-regulated affiliates depreciation and amortization deductions attributable to the § 743(b) basis adjustments.

When the IOU intercompany transfers of the partnership interests occurred, no journal entry was made on Taxpayer's regulated books of account. Its public utility property assets remained within Taxpayer at all times before, during, and after the transaction. Taxpayer represents that the § 743(b) adjustments are not increases in the basis of the property on Taxpayer's regulated books. Further, Taxpayer represents that the § 743(b) adjustments and the depreciation of those adjustments do not change Taxpayer's public utility property for ratemaking purposes and are not associated with Taxpayer's cost of service ratemaking.

Regulator 1 approved Taxpayer's proposed reorganization in its order dated Date 1. That order was conditioned on Taxpayer's representations, including Taxpayer's commitment to hold customers harmless from any transaction-related costs, and Taxpayer's representation that the transaction will not impact their Regulator 1 jurisdictional accounts. Taxpayer's subsequent filing, filed on Date 2, contains the same representations and commitments. In an order dated Date 3, authorizing disposition of the facilities, Regulator 1 again noted Taxpayer's commitment to hold all of their transmission customers harmless from transaction-related costs.

Taxpayer makes the following additional representations. First, the members of the consolidated group will treat the transaction consistent with § 1.1502-13. Second,

the transfers of interests in Taxpayer do not result in a disparity between the partners' basis in their interests in Taxpayer and Taxpayer's basis in its assets. Last, the IOU intercompany transfers did not result in a termination of Taxpayer under § 708(b)(1)(B).

RULING REQUESTED

Taxpayer requests a ruling that a normalization violation will not occur if Taxpayer does not adjust existing ADFIT balances to account for the consequences of the § 743(b) basis adjustment resulting from Taxpayer's restructuring transaction.

LAW AND ANALYSIS

Section 168(f)(2) 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) 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 § 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 that has the power to approve such rates, even if the regulatory body has taken no action on the filed schedule or generally leaves undisturbed rates filed.

The regulations under former § 46, specifically § 1.46-3(g)(2), expand the definition of regulated rates. The 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 § 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, for purposes of applying the normalization rules, the definition of public utility property is the same for purposes of the investment tax credit and depreciation.

Former § 167(l) generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former § 167(l)(3)(G) in a manner consistent with that found in § 168(i)(9)(A). Section 1.167(l)-1(a)(1) provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under § 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

In order to use a normalization method of accounting, § 168(i)(9)(A)(i) requires a taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation for property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under § 168(i)(9)(A)(ii), if the amount allowable as a deduction under § 168 differs from the amount that would be allowable as a deduction under § 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under § 168(i)(9)(A)(i), then the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) provides that one way the requirements of § 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under § 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under § 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base (hereinafter referred to as the "Consistency Rule").

In order to satisfy the Consistency Rule, there must be consistency in the treatment of costs for rate base, regulated depreciation expense, tax expense, and deferred tax revenue purposes. The normalization rules would be violated if the federal income tax component of cost of service reflected depreciation of Taxpayer's costs that are not included in rate base or the depreciation component of cost of service.

Based on the foregoing, we conclude that a normalization violation will not occur if Taxpayer does not adjust existing ADFIT balances to account for the consequences of the § 743(b) basis adjustment resulting from Taxpayer's restructuring transaction. This ruling is expressly conditioned upon Taxpayer's representation that the restructuring transaction will not impact Taxpayer's public utility property for ratemaking purposes and is not associated with Taxpayer's cost of service ratemaking.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal income tax consequences of the above described facts under any other provision of the Code or regulations. Specifically, no opinion was requested, and no opinion is expressed or implied, concerning the application of any consolidated return regulation under § 1502 to the transfers of the partnership interests.

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.

This ruling is based upon information and representations submitted by Taxpayer and accompanied by penalty of perjury statements 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.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

David A. Selig
Senior Counsel, Branch 6
Office of Associate Chief Counsel
(Passthroughs & Special Industries)