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LEGEND

Company	=
Taxpayer	=
State A	=
State B	=
a	=
b	=
County	=
Date 1	=
Date 2	=
Date 3	=
Year 1	=
Year 2	=
Year 3	=
Commission 1	=
Commission 2	=

Dear

This is in response to your recent ruling request concerning the federal income tax consequences with regard to the transaction described below.

BACKGROUND

Taxpayer, a State A corporation, is the parent company of a group of corporations (the Group) that files a U.S. consolidated federal income tax return. The Group includes members that are regulated natural gas and electric utility companies operating in states. The Group files a consolidated federal income tax return on a calendar year basis using accrual methods of accounting.

Company is a State B limited liability company, wholly owned by Taxpayer, and treated as a disregarded entity for U.S. federal income tax purposes. Company is regulated by Commission 1 and participates in a wholesale energy market regulated by Commission 2. As part of its plan to replace a substantial portion of its coal-fueled electric generating fleet, Company intends to invest in and purchase electricity from wind projects. These wind projects are intended to qualify for the production tax credit (PTC) under § 45 of the Internal Revenue Code.

The Facility is located in County. It will have a nameplate capacity of approximately a MW. The Facility is currently being developed by an independent third party developer (Developer). The Facility is owned by Project LLC, a disregarded entity of Developer for U.S. federal income tax purposes. On Date 1, Company entered into a Build Transfer Agreement with Developer pursuant to which Developer will continue to develop the Facility and sell it to Wind JV upon completion. The Facility is expected to be completed before Date 2.

On or before Date 3, Company and an independent investor (Tax Equity Investor) will enter into a joint venture by forming Wind JV LLC (Wind JV). Wind JV will purchase from Developer all of the equity interests in Project LLC. Because Project LLC will be a disregarded entity for U.S. federal income tax purposes, this transaction will be treated as the sale and purchase of the Facility assets.

Wind JV will use the Facility to generate electricity to sell to Company under a wholesale power purchase agreement (PPA). Under the PPA between Company and Wind JV, Company will purchase a% of the electric output and capacity of the Facility. The PPA will have a term of at least b years and will constitute a wholesale PPA under the market-based rate authority of Commission 2. The structure of Wind JV and related transactions, as well as the PPA, are also subject to approval by Commission 1. Prices under the PPA will be determined on a market basis, using a competitive bidding process, and will not be determined on a rate of return basis or cost basis.

Company will also include the electricity purchased from Wind JV under the PPA as part of its system power to provide electric service to Company's retail customers. Company's sale of electricity to its retail customers will be subject to regulation by Commission 1.

Based on the expected completion date, beginning in Year 1 and extending through Year 2, Company will purchase a% of the electrical power produced by the Facility. Accordingly, Company will make ongoing payments to Wind JV pursuant to the PPA. Profits, losses, cash, and PTCs will all be allocated to Company and Tax Equity Investor in accordance with the LLC Agreement.

In Year 3, Company will have an option to purchase all of Tax Equity Investor's interests in Wind JV for fair market value in accordance with the terms of the LLC Agreement. If the option is exercised Company will then own a% of Wind JV.

In the hands of Wind JV, the electricity generated by the Facility will not be subject to rate of return or cost basis regulation by Commission 1.

RULINGS REQUESTED

Rulings have been requested that:

(1) The Facility is not public utility property (or PUP) under § 168(i)(10).
(2) Any losses of Wind JV allocated to Tax Equity Investor will not be disallowed under §707(b).

LAW AND ANALYSIS

Section 168(f)(2) of the Internal Revenue Code (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.

Pursuant to Code §50(d)(2), rules similar to the rules of former Code §46(f) as in effect on November 5, 1990, continue to determine whether or not an asset is PUP for purposes of the investment tax credit normalization rules. As in effect at that time, former Code §46(f)(5) defined PUP by reference to former Code § 46(c)(3)(B).

The regulations under former § 46, specifically § 1.46-3(g)(2), contain a definition of regulated rates that is expanded somewhat from that contained in § 1.167(l)-1(b)(1). This expanded definition embodies the notion of rates established or approved on a rate of return basis. In addition, 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. Therefore, 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.

Under both the depreciation and investment tax credit normalization rule definitions, the property must be predominately used in one of a number of enumerated activities. Aside from the description of certain telecommunications services (which has no relevance to Taxpayer 's situation), the list of activities in

the two definitions are virtually identical. One of these activities is the furnishing or sale of electric energy.

There are, therefore, three characteristics all of which a facility must possess in order to be characterized as PUP:

1. It must be predominately used in the trade or business of the furnishing or sale of electric energy;
2. The rates for such sale must be established or approved by one of the enumerated agencies or instrumentalities; and
3. The rates set by that agency or instrumentality must be established or approved on a rate-of-return basis.

The Facility will be predominantly used in the trade or business of the furnishing or sale of electric energy, and therefore, it will possess the first of the three characteristics. Moreover, as a regulated company subject to the jurisdiction of Commission 2, Wind JV will possess the second of the three characteristics. However, Wind JV will use the Facility to generate electricity to sell to Company under a wholesale PPA. The wholesale PPA between Company and Wind JV will be regulated by Commission 2, but prices under the PPA will be set at arm's length pursuant to an RFP provided to Company by Developer and under Commission 2 regulation will be determined on a market basis and will not be determined on a rate of return basis or cost basis. Because rates on the sale of electricity from the Facility will not be regulated by Commission 2 on a rate of return basis, the Facility will not be PUP. Moreover, Commission 1 will not have any jurisdiction over Wind JV or the Facility, and as a result, could not influence the rates Company will pay for the electricity from the Facility.

Therefore, while the Facility will be used to produce electricity and will be subject to the jurisdiction of Commission 2, and thus possesses the first two characteristics of PUP, the Facility must possess all three characteristics to be considered PUP. For property to be PUP, the electricity generated must be sold at rates that are regulated by a government agency or public utility commission on a rate of return basis. Rates for the sale by Wind JV of electricity generated by the Facility are determined on a market basis and not on a rate of return or cost basis. Thus, the Facility is not PUP under § 168(i)(10).

With respect to the second issue, section 6.09 of Rev. Proc. 2019-1, 2019-1 I.R.B. 1, provides that generally, the Service will not issue a letter ruling or a determination letter if the request presents an issue that cannot be readily resolved before a regulation or any other published guidance is issued.

Accordingly, we conclude:

1. The Facility is not Public Utility Property under §168(i)(10).

2. The Service will not rule on the second issue based on § 6.09 of Rev. Proc. 2019-1.

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.

Sincerely,

Patrick S. Kirwan
Chief, Branch 6
Office of Associate Chief Counsel (Passthroughs & Special Industries)