Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
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Refer Reply To:
CC:PSI:B06
PLR-106179-20

Date:
August 24, 2020

Re:

LEGEND:

Taxpayer	=
Parent	=
Commission	=
State	=
County	=
Customer	=
Airport	=
Location	=
Operator	=
Statute	=
Agreement	=
Program	=
Tariff	=
a	=
b	=
c	=
d	=
e	=
Date 1	=
Date 2	=
Director	=

Dear :

This letter responds to your request, dated March 3, 2020, for a ruling regarding certain federal income tax consequences under § 168(i)(10) and former § 46(f)(5) of the Internal Revenue Code of the proposed transaction described below. The relevant facts as represented in your submission are set forth below.

FACTS

Taxpayer, a State corporation, is a public utility engaged in the generation, transmission, and distribution of electrical energy to State retail customers. Taxpayer is a wholly owned subsidiary of Parent, who is a publicly traded holding company. Parent corporation, and its affiliated group of corporations, including Taxpayer, file a consolidated federal income tax return on a calendar year basis using the accrual method of accounting.

Taxpayer is subject to regulation by Commission. Taxpayer's retail electric distribution services are primarily located in County. Taxpayer's retail electric rates are generally cost-based rates approved by Commission and are a combination of base rates and several separate cost recovery clauses for specific categories of costs. These separate cost recovery clauses address items such as fuel and purchased energy costs, purchased power capacity costs, energy conservation, demand side management programs, and the costs of compliance with environmental laws and regulations. Costs not addressed through one of the specific cost recovery clauses are recovered through Taxpayer's base rates.

Commission approved the Program giving Taxpayer the ability to negotiate unique pricing structures with an existing or a new electric service customer. This pricing would not follow a traditional cost-based utility rate recovery model; instead, the Program would allow deal specific pricing for renewable energy projects. The participating customer and shareholders of Parent would bear the full risk of underlying contractual obligations. Program costs specific to the Program would not be included in the determination of Taxpayer's revenue requirements as it would be directly assigned to the participating customer in any regulatory rate filing before Commission.

Customer is the first customer of Taxpayer to participate in the Program. Customer has a municipal airport (Airport) located at Location. Customer has agreed to let Taxpayer utilize a portion of Airport land to build a a kW-AC photovoltaic array (Facility). Customer has contracted for an undivided interest in b kW-AC of the Facility as a dedicated renewable energy facility (DREF) to serve a portion of Customer's electrical load. The energy generated by the DREF will be delivered to Customer's metered locations within Taxpayer's service territory to offset Customer's load. Any excess energy generated by the DREF will be sold to Operator's energy market. Rates for

energy sold to Operator in excess of Customer's requirements are based on the wholesale energy market which is market-based.

Pricing of energy coming from the DREF to Customer follows the terms and conditions of the Agreement, which was negotiated and agreed upon by Taxpayer and Customer in an arms-length transaction. Generally, a public utility may not enter into an individual contract to charge one customer a different rate than other customers. However, under State Statute, a public utility can request approval from Commission for an individual contract. The Agreement was executed by Taxpayer and Customer on Date 1 and approved by Commission on Date 2.

The Program's Tariff specifies that costs attributable to the DREF will be recovered through a volumetric charge based on actual energy generated by the DREF and delivered to the Customer. The Program's Tariff provides for a levelized rate of $c/kWh in the first year of operation, adjusted for inflation annually at d% for the e-year agreement term. The Program's Tariff rate is intended to provide Taxpayer with sufficient cash flows to meet its required risk adjusted market-based return.

RULING REQUESTED

Taxpayer requested the following ruling:

That the portion of Facility that is the DREF serving Customer shall not be considered "public utility property" within the meaning of Code § 168(i)(10) and former Code § 46(f)(5).

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, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

Prior to the Revenue Reconciliation Act of 1990, § 168(i)(10) defined public utility property by means of a cross reference to § 167(l)(3)(A). Section 167(l)(3)(A) as then in effect contained the same definition of public utility property that is currently in § 168(i)(10). 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. Pursuant to § 50(d)(2), rules similar to the rules of former § 46(f), as in effect on November 5, 1990, continue to determine whether an asset is public utility property for purposes of the investment tax credit normalization rules. As in effect at that time, former § 46(f)(5) defined public utility property by reference to former § 46(c)(3)(B).

The regulations under former § 46 (of continuing applicability by virtue of § 50(d)(2)), specifically § 1.46-3(g)(2)(iii), contains an expanded definition of regulated rates. This expanded definition embodies the notion of rates established or approved on a rate of return basis; where rate of return includes a fair return on the taxpayer’s investment in providing such goods and services. Furthermore, rates are not “regulated” if they are established or approved on the basis of maintaining competition within an industry, insuring adequate service to customers of an industry, or charging “reasonable” rates within an industry. In addition to the definition in the § 46 regulations, 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.

Thus, under both the depreciation and investment tax credit normalization rule definitions, a facility must meet three requirements to be considered public utility property:

(1) It 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.

Taxpayer will predominantly use the DREF in the trade or business of the furnishing or sale of electric energy. Therefore, the DREF will meet the first requirement. In addition, Taxpayer is a regulated public utility company subject to the jurisdiction of Commission. Therefore, the DREF will also meet the second requirement.

However, as described above, the rate Taxpayer charges for electricity to be produced by the DREF will be the negotiated, market-based price that was agreed upon in the Agreement between Customer and Taxpayer. Any electricity produced in excess of Customer's requirements will be sold to Operator at wholesale, market-based rates. These rates will be the only source of compensation to Taxpayer for electricity produced from the DREF. The rate established for the sale of electrical energy from the DREF to Customer under the terms of the Agreement does not include recovery of Taxpayer's costs on a cost-of-service, rate-of-return basis. The portion of the costs related to the DREF will not be included in the determination of Taxpayer's revenue requirements. Therefore, the DREF will not meet the third requirement. Accordingly, we conclude that the portion of Facility that is the DREF serving Customer will not be public utility property within the meaning of § 168(i)(10) and former § 46(f)(5).

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). In addition, no opinion is expressed concerning whether Taxpayer is the owner of Facility generating electricity for federal income tax purposes.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. This ruling is based upon information and representations submitted on behalf of 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 a ruling, 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 representative. We are also sending a copy of this letter to the Director.

Sincerely,

Jennifer A. Records
Jennifer A. Records
Senior Technician Reviewer, Branch 6
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

cc: