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Department of the Treasury
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Person To Contact:
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Date:
July 01, 2021

In Re:

LEGEND:

Taxpayer	=
Parent	=
Commission A	=
Commission B	=
Operator	=
State	=
Agreement	=
Partnership	=
Location	=
a	=
b	=
c	=
d	=
Date 1	=
Year A	=
Director	=

Dear

This letter responds to your request, dated November 30, 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

Parent and Taxpayer, both State corporations, file a consolidated federal income tax return on a calendar year basis with their affiliates. Taxpayer is a public utility engaged principally in the generation and distribution of electricity and the distribution and transportation of natural gas to retail customers in select markets in State.

Taxpayer is subject to regulation by Commission A and Commission B with respect to the terms and condition of its services, including the rates it may charge for such services. Taxpayer is also participated under an Agreement with Operator and is subject to the terms and conditions of the Operator Tariff.

On Date 1, Taxpayer entered into a Build Transfer Agreement (BTA) with an independent third party (Developer), via a wholly-owned special purpose entity subsidiary (ProjectCo) to build an a Megawatt (MW) solar-powered electric generating facility (Facility). Facility is to be located at Location and is expected to be placed in service in Year A. Upon mechanical completion of the Facility, Taxpayer will sell its membership interest in ProjectCo to Partnership. ProjectCo is a disregarded entity of Partnership and Partnership will be the ultimate owner of Facility for Federal Tax purposes.

Taxpayer and partners will each contribute cash to Partnership for the purposes of purchasing Facility under the terms of an LLC agreement. Partnership will file for and receive market-based authority from Commission B, allowing it to make any sales of electricity, capacity, and ancillary services at market-based rates, rather than cost-based rates with a regulated rate-of-return.

Partnership will use Facility to generate electricity and then sell the electricity to Taxpayer under a wholesale power purchase agreement (PPA). The PPA will be subject to separate approval by Commission B because Partnership will be an affiliate of Taxpayer. All parties to the PPA will expressly agree that it should be treated as a service contract under section 7701(e)(3) and that Taxpayer is a conduit for the delivery of energy by Partnership into Operator's markets.

Under the PPA Taxpayer will purchase b% of the electric output and capacity of the Facility. The PPA will have a term of at least c years and will constitute a wholesale contract under the jurisdiction of Commission B. Prices under the PPA will be determined on an arm's length, market basis pursuant to market-based rate authority granted by Commission B and will not be determined on a rate-of-return basis or cost of service basis.

Taxpayer will acquire electricity from the wholesale electricity markets at market prices as administered by Operator. The timing and volumes of purchased power will be determined based on demand for power by Taxpayer's customers in the normal course of business operations and without regard to the timing and volumes of power sold by Partnership.

As part of the proceedings with Commission A, Taxpayer is requesting that it be able to include the cost of its investment in Partnership in rate base and that it be able to recover the cost of its investment in Partnership ratably over d years.

Taxpayer expects that Facility will qualify for the Investment Tax Credit (ITC) provided in §48. Profits, losses, cash, and ITCs of Partnership will be allocated in accordance with the LLC agreement.

RULINGS REQUESTED

Taxpayer requested the following ruling:

The Facility will not be Public Utility Property Under section 168(i)(10), and therefore related depreciation deductions and ITC will not be subject to the normalization rules of section 168(i) or former section 46(f).

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.

Section 761(a) of the Code defines the term ‘partnership’ and describes a type of partnership that at the election of all members may exclude itself from partnership treatment. A partnership not meeting such description may not elect to exclude itself from partnership treatment.

Section 1.761-2(a)(3) of the regulations provides that eligibility for the election provided by section 761(a) of the Code requires three principal elements. To the extent relevant, this section provides that where the participants in the joint use of property (i) own the property as coowners, (ii) reserve the right separately to take in kind or dispose of their shares of any property produced, extracted, or used, and (iii) do not jointly sell services or the property produced or extracted, then the unincorporated organization may elect to be excluded from subchapter K of the Code.

Section 1.167(1)-3(c) of the regulations provides that if property held by a partnership is not public utility property in the hands of the partnership, but would be public utility property if an election were made under section 761 to be excluded from partnership treatment, then section 167(1) shall be applied by treating the partners as directly owning the property in proportion to their partnership interests.

Partnership will predominantly use the Facilities in the trade or business of the furnishing or sale of electric energy. Therefore, the Facility will meet the first requirement. In addition, Partnership will be under the jurisdiction of Commission B. Therefore, the Facility will also meet the second requirement.

However, as described above, the rates charged by Partnership to Operator for electricity to be produced by the Facility are determined under the market-based rate authority of Commission B (not on a cost-of-service or rate-of-return basis). Accordingly, we conclude that Facility owned by Partnership will not to be public utility property within the meaning of § 168(i)(10) and former § 46(f)(5).

Except as explicitly 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, Taxpayer has not requested a ruling regarding whether Partnership will be respected as a partnership for federal income purposes nor provided partnership agreements for Partnership. Accordingly, nothing in this letter should be construed as providing a ruling or other determination that the Partnership will be respected as partnership or that any purported owner will be respected as a partner for federal income tax purposes. In addition, we express no opinion regarding whether the PPA will should be treated as a service contract under § 7701(e)(3).

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,

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

cc: