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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:5
PLR-145294-14

Date:
February 03, 2016

In Re:

Legend

Taxpayer =

Corp 1 =

Entity =

Generator =

State =

Town =

Dear :

This letter responds to a request for a ruling dated December 11, 2014, submitted on behalf of Taxpayer by your authorized representative. Taxpayer requested a ruling that certain payments by Generator to Taxpayer do not constitute a contribution in aid of construction under § 118(b) of the Internal Revenue Code and are excludable from gross income as a nonshareholder contribution to capital under § 118(a). The relevant facts as represented in your submission are set forth below.

Taxpayer is a an electric distribution company providing electric distribution services to approximately customers in cities and towns in State. Its properties consist principally of substations and distribution lines interconnected with transmission lines and other facilities of Corp 1. Taxpayer entered into an

(the “Interconnection Agreement”) with Generator with respect to Generator’s stand-alone solar electric generation facility (the “Facility”) located in Town. All of the electricity generated by the Facility, other than the electricity consumed by the Facility for its operations, is sold to Entity. Following the sale of electricity from the Facility to Entity, the electricity passes through Taxpayer’s Intertie and is delivered to Taxpayer’s distribution system. There is no direct interconnection between the Facility and any electric transmission system.

The Interconnection Agreement, effective as of , permits Generator to connect the Facility to the electric grid system. The Interconnection Agreement has an indefinite term, but is terminable by either party upon days written notice or upon certain specified events. Pursuant to the Interconnection Agreement, Taxpayer agreed to construct the Taxpayer Intertie (the “Intertie”), which involved: (1) constructing a ; (2) removing a ; (3) replacing a ; (4) upgrading a ; and (5) undertaking . The total cost of the Intertie was $, which Generator paid Taxpayer in two equal payments of $ on , and . Taxpayer holds legal title to the Intertie, and the Intertie is a permanent part of Taxpayer’s electric distribution system.

The Generator and Entity are parties to a power purchase agreement (the “PPA). The term of the PPA is years, commencing on , which is the effective date of the PPA. Under the PPA, Entity purchases and takes legal title and ownership of all electricity generated by the Facility (not used by the Facility itself), and title and ownership passes to Entity before it travels through the busbar at the Intertie and onto Taxpayer’s distribution line. All of the electricity purchased by Entity under the PPA is delivered through Taxpayer’s electric distribution system.

Taxpayer makes the following representations: (1) the Facility is a QF; (2) the Intertie will be used in connection with the distribution of electricity for sale to third parties; (3) the cost of the Intertie will not be included in Taxpayer’s rate base; (4) the term of the PPA is years; (5) title and ownership of the electricity generated by the Facility passes from the Generator to Entity at or prior to the busbar on the Facility’s end of the Intertie; (6) Taxpayer will not claim depreciation or amortization deductions with respect to the Intertie; (7) the amount of the interconnection payment will be capitalized by Generator as an intangible asset and amortized over 20 years; (8) no more than 5% of the electricity will flow from Taxpayer over the Intertie during the first ten years beginning on the date on which the Intertie was placed in service; (9) there is no direct interconnection between the Facility and an electric transmission system; and (10) there is a direct interconnection between the Facility and an electric distribution system.

Taxpayer requests a ruling that the amount of the payment by Generator to Taxpayer for the Intertie will not constitute a contribution in aid of construction under § 118(b) and will be excludable from the gross income of Taxpayer as a nonshareholder contribution to capital under § 118(a).

Section 61(a) and § 1.61-1 of the Income Tax Regulations provide that gross income means all income from whatever source derived, unless excluded by law.

Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.

Section 118(b) provides that the term "contribution to the capital of taxpayer" does not include any contribution in aid of construction or any other contribution as a customer or potential customer.

Section 1.118-1 of the Income Tax Regulations provides, in part, that § 118 also applies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of enabling the corporation to expand its operating facilities. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid to induce the taxpayer to limit production.

The legislative history to § 118 indicates that the exclusion from gross income for nonshareholder contributions to capital of a corporation was intended to apply to those contributions that are neither gifts, because the contributor expects to derive indirect benefits, nor payments for future services, because the anticipated future benefits are too intangible. The legislative history also indicates that the provision was intended to codify the existing law that had developed through administrative and court decisions on the subject. H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 17 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 18-19 (1954).

Notice 88-129, 1988-2 C.B. 541, as modified and amended by Notice 90-60, 1990-2 C.B. 345, and Notice 2001-82, 2001-2 C.B. 619, provides specific guidance with respect to the treatment of transfers of property to regulated public utilities by qualifying small power producers and qualifying cogenerators (collectively, Qualifying Facilities), as defined in section 3 of the Federal Power Act, as amended by section 201 of PURPA.

The amendment of § 118(b) by the 1986 Act was intended to require utilities to include in income the value of any CIACs made to encourage the provision of services by a utility to a customer. See H.R. Rep. No. 841, 99th Cong., 2d Sess. 324 (1986). In a CIAC transaction, the purpose of the contribution of property to the utility is to facilitate the sale of power by the utility to a customer. In contrast, the purpose of the

contribution by a Qualifying Facility to a utility is to permit the sale of power by the Qualifying Facility to the utility. Accordingly, the fact that the 1986 amendments to § 118(b) render CIAC transactions taxable to the utility does not require a similar conclusion with respect to transfers from Qualifying Facilities to utilities.

Notice 88-129 provides that with respect to transfers made by a Qualifying Facility to a utility exclusively in connection with the sale of electricity by the Qualifying Facility to the utility, a utility will not realize income upon transfer of interconnection equipment (intertie) by a Qualifying Facility. The possibility that an intertie may be used to transmit power to a utility that will in turn transmit the power across its transmission network for sale by the Qualifying Facility to another utility (wheeling) will not cause the contribution to be treated as a CIAC.

Further, the notice provides that a transfer from a Qualifying Facility to a utility will not be treated as a Qualifying Facility transfer (QF transfer) under this notice to the extent the intertie is included in the utility's rate base. Moreover, a transfer of an intertie to a utility will not be treated as a QF transfer under this notice if the term of the power purchase contract is less than ten years.

The notice also provides that a utility that constructs an intertie in exchange for a cash payment from a Qualifying Facility pursuant to a PURPA contract will be deemed to construct the property under contract and will recognize income from the construction in the same manner as any other taxpayer constructing similar property under contract. Subsequent to the construction of the property, the Qualifying facility will be deemed to transfer the property to the utility in a QF transfer that will be treated in exactly the same manner as an in-kind QF transfer.

Notice 2001-82 amplifies and modifies Notice 88-129. Notice 2001-82 extends the safe harbor provisions of Notice 88-129 to include transfers of interties from non-Qualifying Facilities, and transfers of interties used exclusively or in part to transmit power over the utility's transmission grid for sale to consumers or intermediaries (wheeling). The notice requires that ownership of the electricity wheeled passes to the purchaser prior to its transmission on the utility's transmission grid. This ownership requirement is deemed satisfied if title passes at the busbar on the generator's end of the intertie. Further, Notice 2001-82 provides that a long-term interconnection agreement in lieu of a long-term power purchase contract may be used to satisfy the safe harbor provisions of Notice 88-129 in wheeling transactions. Finally, Notice 2001-82 requires that the generator must capitalize the cost of the property transferred as an intangible asset and recover such cost using the straight-line method over a useful life of 20 years.

The legislative history of § 118 provides, in part, as follows:

> This [§ 118] in effect places in the Code the court decisions on the subject. It deals with cases where a contribution is made to a corporation by a governmental unit, chamber of commerce, or other association of individuals having no proprietary interest in the corporation. In many such cases because the contributor expects to derive indirect benefits, the contribution cannot be called a gift; yet the anticipated future benefits may also be so intangible as to not warrant treating the treating the contribution as a payment for future services.

S. Rep. No. 1622, 83d Cong., 2d Sess. 18-19 (1954).

In Detroit Edison Co. v. Commissioner, 319 U.S. 98 (1943), the Court held that payments by prospective customers to an electric utility company to cover the cost of extending the utility's facilities to their homes, were part of the price of service rather than contributions to capital. The case concerned customers' payments to a utility company for the estimated cost of constructing service facilities (primary power lines) that the utility company otherwise was not obligated to provide. The customers intended no contribution to the company's capital.

Later, in Brown Shoe Co. v. Commissioner, 339 U.S. 583 (1950), 1950-1 C.B. 38, the Court held that money and property contributions by community groups to induce a shoe company to locate or expand its factory operations in the contributing communities were nonshareholder contributions to capital. The Court reasoned that when the motivation of the contributors is to benefit the community at large and the contributors do not anticipate any direct benefit from their contributions, the contributions are nonshareholder contributions to capital. Id. at 41.

Finally, in United States v. Chicago, Burlington & Quincy Railroad Co., 412 U.S. 401, 413 (1973), the Court, in determining whether a taxpayer was entitled to depreciate the cost of certain facilities that had been funded by the federal government, held that the governmental subsidies were not contributions to the taxpayer's capital. The court recognized that the holding in Detroit Edison Co. had been qualified by its decision in Brown Shoe Co. The Court in Chicago, Burlington & Quincy Railroad Co. found that the distinguishing characteristic between those two cases was the differing purpose motivating the respective transfers. In Brown Shoe Co., the only expectation of the contributors was that such contributions might prove advantageous to the community at large. Thus, in Brown Shoe Co., since the transfers were made with the purpose, not of receiving direct services or recompense, but only of obtaining advantage for the general community, the result was a contribution to capital.

The Court in Chicago, Burlington & Quincy Railroad Co. also stated that there were other characteristics of a nonshareholder contribution to capital implicit in Detroit Edison Co. and Brown Shoe Co. From these two cases, the Court distilled some of the

characteristics of a nonshareholder contribution to capital under both the 1939 and 1954 Codes. First, the payment must become a permanent part of the transferee's working capital structure. Second, it may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee. Third, it must be bargained for. Fourth, the asset transferred foreseeably must benefit the transferee in an amount commensurate with its value. Fifth, the asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect.

In the instant case, the transfer of the Intertie is not subject to the guidance set forth in Notice 88-129, Notice 90-60, and Notice 2001-82 because there is no direct interconnection between the Facility and an electric transmission system, as contemplated under Notice 88-129 and Notice 2001-82. In addition, we believe that Generator lacked the requisite motivation to make a nonshareholder contribution to capital under Brown Shoe Co. v. Commissioner, and United States v. Chicago, Burlington & Quincy Railroad Co because the Generator made the contribution in order to sell electricity. Accordingly, based solely on the foregoing analysis and the representations made by Taxpayer, we rule that the transfer of the Intertie by Generator to Taxpayer is a CIAC under § 118(b) and is not excludable from the gross income of Taxpayer as a nonshareholder contribution to capital under § 118(a).

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.

This ruling is directed only to the taxpayer who requested 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 a penalty of perjury statement 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,

Nicole Cimino
Senior Technician Reviewer, Branch 5
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes