Internal Revenue Service

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Department of the Treasury
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
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Date:
April 04, 2017

In Re:

Legend

Taxpayer =

Corp 1 =

Administrator 1 =

Administrator 2 =

Agreement 1 =

Agreement 2 =

Dear :

This letter responds to a request for a ruling dated August 1, 2014, and subsequent correspondence submitted on behalf of Taxpayer by your authorized representatives. Taxpayer requested a ruling that certain payments Taxpayer received from independent generators ("Generators") are contributions to the capital of Taxpayer under § 118(a) of the Internal Revenue Code. The relevant facts as represented in your submission are set forth below.

FACTS

Taxpayer is an investor-owned utility that supplies natural gas to customers and electricity to customers. Taxpayer is a corporation under law. Taxpayer is part of an affiliated group of corporations of which Corp 1 is the common parent. Corp 1 files a consolidated federal income tax return for all members of the affiliated group, including Taxpayer. Corp 1 uses a calendar tax year and the accrual method of accounting.

Taxpayer signed Agreement 1 and Agreement 2 (collectively, “Agreements”) with Generators who collectively own wind farms in . Pursuant to Agreements, Taxpayer will make certain upgrades to its transmission grid in exchange for compensation from Generators. The payments under Agreements are being made in an effort by Generators to increase the deliverability of their generation, avoid curtailment, and prevent violations of operating limits on transmission equipment owned by Taxpayer.

Taxpayer transferred functional control of its transmission system to Administrator 1, a regional transmission organization ("RTO") and independent system operator that oversees the grid in portions of the . The wind farms are connected either to Administrator 1 or a neighboring RTO, Administrator 2. Administrator 2 coordinates the movement of electricity through all or parts of

. Each generator has an interconnection agreement with a utility that is a member of either Administrator 1 or Administrator 2. of the wind farms interconnect with in Administrator 2. The other interconnect with utilities in Administrator 1, with and with Taxpayer.

Administrator 1 and Administrator 2 grids are joined to each other. The volume of electricity being carried on a section of the Administrator 2 grid can lead to increased flow or congestion on the Administrator 1 grid and vice versa. In a case when market processes are not effective, Administrator 1 can notify Administrator 2 of the need for Administrator 2 to curtail some generators on its system and vice versa when needed to relieve congestion or prevent system operating limits from being exceeded. In , Administrator recommended upgrades to and circuits on Taxpayer’s system to increase the thermal limits and, in turn, reduce the potential for limit violations in order to increase available capacity. Generators and Taxpayer then entered into Agreements.

Taxpayer agreed in Agreement 1 to re-conductor circuits running between its substations and from the substation to a line to increase the carrying capacity to . Taxpayer also agreed to re-conductor circuits from the line to its substation and from the substation to the substation to increase the capacity

to . Taxpayer agreed in Agreement 2 to install conductors on transmission towers and upgrade terminal equipment to increase the carrying capacity of the circuits between its to . Taxpayer also agreed to address a clearance issue with one transmission line and reposition another line to operate the circuit at a higher operating temperature, resulting in an increase to between its substations.

Taxpayer does not provide transmission services to any of Generators. Two generators directly interconnect with Taxpayer and buy auxiliary power from Taxpayer. Auxiliary power purchased has historically accounted for and is anticipated to be well under 5% of total power flows in both directions over each such generator's intertie. Generators have represented to Taxpayer that it sells the output from its wind farms to customers at the point that the electricity exits the generating facility and before the electricity reaches the grid.

Taxpayer will own the transmission upgrades. Taxpayer will not add the amount it spends on the capital costs of the upgrades into rate base and will not recover the amount of the capital costs of the upgrades from its transmission customers through the rates it charges. Generators have represented to Taxpayer that they will treat their payments to Taxpayer as basis in intangible assets and recover the amounts for tax purposes on a straight-line basis over 20 years.

RULING REQUESTED

Taxpayer requests a ruling that the contribution of the intertie, and all sums paid for construction of the intertie are not a contribution in aid of construction (CIAC) under § 118(b), and are excludable from Taxpayer's gross income as a non-shareholder contribution to capital under § 118(a).

LAW AND ANALYSIS

Section 61 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 the 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 that in the case of a corporation, § 118 provides an exclusion from gross income with respect to any contribution of money or property to the capital of the taxpayer. Thus, if a corporation

requires additional funds for conducting its business and obtains such funds through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special account, such amounts do not constitute income, although there is no increase in the outstanding shares of stock of the corporation. In such a case the payments are in the nature of assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. Section 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 inducing the corporation to locate its business in a particular community, or for the purpose of enabling the corporation to expand its operating facilities.

Notice 2016-36, 2016-36 provides a safe harbor for transfers of property from either an electricity generation or cogeneration facility or an energy storage facility to a regulated public utility, used to facilitate the transmission of electricity over the utility's transmission system, to be treated as a contribution to the capital of a corporation under § 118(a), and not a contribution in aid of construction (CIAC) under § 118(b).

The safe harbor provides that a contribution of an intertie, including a dual-use intertie, by a generator to a utility will not be treated as gross income under § 118(a) or a CIAC under § 118(b) if all of the following conditions are met. First, the generator may not purchase electricity from the utility, unless the purchase satisfies the 5% test. The 5% test provides that if, in light of all information available to the utility at the time the intertie is contributed, it is reasonably projected that, during the ten taxable years of the utility beginning with the year in which the contributed intertie is placed in service, no more than 5% of the projected total power flows over the intertie will flow to the generator, the 5% test will be satisfied. This projection must be supported by appropriate documentation. Total power flows mean power flows to or from the generator over the intertie. Power flows to a generator include power flows to a related party of the generator, if the transmission of power to the related party has been facilitated by the contribution of the intertie. For purposes of the 5% test, power flows in the taxable year in which the transferred property is placed in service may, at the option of the utility, be ignored. Power purchases by the generator from parties other than the utility are not taken into account.

Second, in the case of electricity wheeled over the utility's transmission system, ownership of the wheeled electricity remains with the generator prior to its transmission onto the grid. This ownership requirement is deemed to be satisfied if title to electricity wheeled passes to the purchaser at the busbar on the generator's end of the intertie. Third, the cost of the intertie is not included in the utility's rate base. Fourth, the intertie will be used for transmitting electricity. Finally, the cost of the intertie is capitalized by the generator as an intangible asset and recovered using the straight-line method over a useful life that is treated as 20 years. A utility may not claim depreciation (or

amortization) deductions with respect to the intertie. However, if the intertie is subsequently transferred or deemed transferred to the utility, the utility may be allowed to take depreciation deductions with respect to the intertie.

Section VIII of Notice 2016-36 provides that the IRS will not issue private letter rulings involving the safe harbor under Notice 2016-36. Further, section 6.09 of Rev. Proc. 2017-1, 2017-1 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. Section 3.01(24) of Rev. Proc. 2017-3 provides that the Service will not issue rulings or determination letters concerning whether a transfer of an intertie, as defined in section III. B. 2. of Notice 2016–36 meets all of the requirements under the safe harbor provided by Notice 2016–36. In this case, Taxpayer requested the private letter ruling before the project that led to publication of Notice 2016-36 was opened and before the addition of this area to Rev. Proc. 2017-3. In the interest of sound tax administration and because the circumstances of this particular case warrant the issuance of a private letter ruling, we are issuing this private letter ruling.

In the instant case, the transfer of the intertie is subject to the guidance set forth in Notice 2016-36, and we conclude that the deemed contribution of the intertie by Generators to Taxpayer meets the safe harbor requirements of Notice 2016-36. Therefore, the deemed contribution of the intertie to Taxpayer, and all sums paid for construction of the intertie are not a CIAC under § 118(b), and are excludable from Taxpayer's gross income as a non-shareholder contribution to capital under § 118(a).

A change in a utility's treatment of a transfer of an intertie, including a change to or from the safe harbor method of accounting provided in section III of Notice 2016-36, is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. A utility that wants to change to the methods of accounting described in this notice must use the automatic change procedures in Rev. Proc. 2015-13, 2015-5 I.R.B. 419, or its successor. Taxpayer should follow the instructions under section 15.16 of Rev. Proc. 2016-29, 2016-21 I.R.B. 880 with respect to the transaction described in this letter ruling.

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 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 the 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
Chief, Branch 5
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: 6110 copy