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November 26, 2019

In Re:

LEGEND:

Taxpayer =

Acquirer =

REIT =

Disregarded Entity =

Former Disregarded Entity =

LLC =

LLC 2 =

Managing Member =

Holdco =

Merger Sub =

Merger Partnership =

Acquirer Affiliate =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

State A =

State B =

State C =

Commission =

Area A Assets =

Area B Assets =

Date 1 =

Date 2 =

Dear :

This letter responds to a request for a private letter ruling dated June 7, 2019, and submitted on behalf of Taxpayer for a ruling concerning the application of the depreciation normalization rules under § 168(i)(9) of the Internal Revenue Code and § 1.167(l)-1 of the Income Tax Regulations (together, the "Normalization Rules") to the direct or indirect acquisition of all of the partnership interests in Taxpayer by Acquirer in a transaction subject to § 743(b). The relevant facts as represented in your submission are set forth below.

FACTS

Taxpayer is a State A limited partnership that is classified as a partnership for federal income tax purposes. REIT, a publicly-traded State B corporation, which is classified as a real estate investment trust for federal income tax purposes, was the general partner of Taxpayer prior to the consummation of the transactions described in this letter. REIT owned approximately a percent of the general and limited partnership interests in Taxpayer. Certain members of management and other investors owned approximately b percent of the limited partnership interests in Taxpayer.

Taxpayer owns c percent of the interests in Disregarded Entity, which is disregarded as an entity separate from Taxpayer for federal income tax purposes. Disregarded Entity was formerly known as Former Disregarded Entity. Former Disregarded Entity was one of two members of LLC. LLC is now known as LLC 2. However, for purposes of this private letter ruling, both LLC and LLC 2 will be referred to as LLC.

LLC owns regulated electricity transmission facilities and certain electricity distribution substations in State C. Prior to the consummation of the transactions described in this letter, Managing Member was the managing member of LLC, and LLC was classified as a partnership for federal income tax purposes. However, pursuant to the transactions, all of Managing Member's interest in LLC was cancelled, which caused LLC to become wholly owned by Former Disregarded Entity and an entity disregarded from Taxpayer for federal income tax purposes. Until the consummation of the transactions, LLC leased the transmission facilities and electricity distribution substations to Managing Member, which operated these facilities and substations.

Since the consummation of the transactions described below, Acquirer, on behalf of LLC, has operated the electricity transmission facilities and distribution substations pursuant to an operation and service agreement. The operation of the electricity transmission facilities and distribution substations is subject to the regulatory jurisdiction of the Commission with respect to rates and conditions of services. The rates for the transmission and distribution services are established under traditional ratemaking on a cost of service, rate of return basis. Although LLC was taxed as a partnership, LLC maintained accumulated deferred federal income tax ("ADFIT") on its regulatory books of account as an entity in the same manner as it would maintain ADFIT if it were a corporation.

Acquirer is a State A limited liability company that is classified as a partnership for federal income tax purposes. Acquirer owns and operates a regulated electricity transmission and distribution system in State C. Acquirer's operations are subject to the regulatory jurisdiction of Commission with respect to rates and conditions of service. The rates for its distribution and transmission services are established under traditional ratemaking on a cost of service, rate of return basis.

Merger Sub is a State A limited liability company that was formed by Acquirer in connection with the transactions. Merger Sub is a wholly-owned subsidiary of Acquirer which is disregarded as an entity separate from Acquirer for federal income tax purposes. Merger Partnership was a State A limited partnership formed by Acquirer in connection with the transactions. Immediately prior to the Partnership Merger (as defined in this letter), all of the economic interest of Merger Partnership was held by Merger Sub, and Merger Partnership was disregarded as an entity separate from Acquirer for federal income tax purposes.

Acquirer Affiliate is a State A limited partnership formed by Acquirer in connection with the transactions. Acquirer Affiliate is an indirectly wholly-owned subsidiary of Acquirer which is classified as a partnership for federal income tax purposes. Acquirer's main purpose in consummating the transactions was to expand its operations.

The transactions

On Date 1, the parties consummated the following transactions pursuant to the Agreement and Plan of Merger (the "Asset Exchange Agreement"), dated Date 2, by and among Managing Member, LLC, and Acquirer, and the Agreement and Plan of Merger (the "Merger Agreement"), dated Date 2, by and among Acquirer, Merger Sub, Merger Partnership, REIT, and Taxpayer:

1) Managing Member's profits interest in LLC, which had a capital account balance and liquidation value (within the meaning of Notice 2005-42, 2005-1 C.B. 1221) of $k, was cancelled, causing LLC to become directly wholly-owned by Former Disregarded Entity (the "Managing Member Interest Cancellation").

2) Pursuant to the Asset Exchange Agreement, (i) Managing Member transferred to LLC certain electric transmission and distribution assets (Area A Assets) with an estimated value of approximately d dollars and (ii) LLC transferred to Managing Member certain electric transmission and distribution assets (Area B Assets) with an estimated value of approximately e dollars and approximately f in cash. The value of the Area B Assets was less than g percent of the cash consideration paid in the Mergers (as defined in this letter). The transactions described in this step are referred to as the "Asset Exchange."

3) Immediately after Step 2, REIT was merged with and into Merger Sub (the "REIT Merger") with Merger Sub surviving. As a result, Acquirer acquired an approximately a percent interest in Taxpayer in exchange for the cash consideration paid pursuant to the REIT Merger.

4) Immediately after the REIT Merger, (i) Merger Sub assigned to Acquirer Affiliate h percent of the general partner interest in Taxpayer, representing h percent of a i percent economic interest in Taxpayer, (ii) Merger Sub assigned to Holdco i percent of the general partner interest in Taxpayer, representing i percent of a i percent economic interest in Taxpayer, and (iii) Holdco assigned to Acquirer Affiliate i percent of the general partner interest in Taxpayer (the "Assignments").

5) After the assignment in Step 4, Merger Partnership was merged with and into Taxpayer, with Taxpayer surviving (the "Partnership Merger" and together with the REIT Merger, the "Mergers"). As a result, Acquirer acquired an approximate b percent interest in Taxpayer in exchange for the cash consideration paid pursuant to the Partnership Merger.

Result of the consummation of the transactions

1) Acquirer Affiliate is the general partner of Taxpayer, which general partner interest is a i percent economic interest in Taxpayer, and Merger Sub owns the limited partner interest in Taxpayer, which limited partner interest represents a h percent economic interest in Taxpayer.

2) Former Disregarded Entity continues to be wholly-owned by Taxpayer.

3) LLC is wholly-owned by Former Disregarded Entity.

4) Former Disregarded Entity and LLC are treated as disregarded entities whose assets (and liabilities) are deemed to be owned by Taxpayer for tax purposes.

Taxpayer intends to satisfy the Commission-approved debt-to-equity ratio for LLC through the issuance of notes payable from LLC to Acquirer. Taxpayer does not intend to have any third-party external debt. Distributions from Taxpayer, other than payments on the notes outstanding to Acquirer, will be made h percent to Merger Sub and i percent to Acquirer Affiliate.

Taxpayer's tax characterization of the steps in the transaction

1) The Managing Member Interest Cancellation in Step 1 of the transaction (i) caused LLC to be deemed to liquidate and become an entity disregarded from Taxpayer and (ii) is properly treated as a tax-free distribution under § 731(a) of all of LLC's assets by LLC to Taxpayer. Taxpayer represents that no portion of the distribution is treated as a distribution described in § 751(b)

and that Taxpayer's basis in the LLC's assets does not exceed the adjusted basis of such assets in the hands of LLC for purposes of § 168(i)(7)(A).

2) The Asset Exchange in Step 2 of the transaction is properly treated as a like-kind exchange under § 1031 between LLC and Managing Member of the Area B Assets for the Area A Assets (and cash). Substantially all of this exchange is treated as an exchange of properties that are of "like kind" within the meaning of § 1031 and, thus, qualify for tax deferred treatment. LLC may, however, have some amount of "exchange group deficiencies" and/or "exchange group surpluses" within the meaning of § 1.1031(j)-1(b) and, thus, may recognize some amount of taxable gain in the Asset Exchange.

3) The REIT Merger described in Step 3 of the transaction is properly treated as a taxable sale by REIT of all of the REIT's assets, substantially all of which consist of the REIT's general and limited partnership interests in Taxpayer, to Acquirer in exchange for the aggregate amount of cash payable pursuant to the REIT Merger and the assumption of all of the REIT's liabilities (including REIT's share of the liabilities of Taxpayer allocable to the partnership interests treated as sold), followed by a distribution of such cash to the stockholders of the REIT in a liquidation of the REIT which is described in § 331. The taxable sale of the REIT's general and limited partnership interests in Taxpayer to Acquirer is properly treated under § 741 as a sale of partnership interests in Taxpayer.

4) The Assignments described in Step 4 of the transaction are properly treated as (i) a tax-free contribution under § 351 of i percent of the general partner interest in Taxpayer by Acquirer to Holdco, (ii) a tax-free contribution under § 721 of i percent of the general partner interest in Taxpayer by Holdco to Acquirer Affiliate, and (iii) a tax free contribution under § 721 of h percent of the general partner interest in Taxpayer by Acquirer to Acquirer Affiliate.

5) The Partnership Merger described in Step 5 of the transaction is properly treated under § 741 as a sale of partnership interests in Taxpayer (other than those partnership interests already held by Merger Sub or the Acquirer Affiliate prior to the consummation of the Partnership Merger) to Acquirer in exchange for the aggregate amount of cash payable pursuant to the Partnership Merger plus the portion of the liabilities of Taxpayer which are allocable to the holders of the partnership interests treated as sold.

Taxpayer is not requesting any rulings regarding the foregoing tax characterization/tax treatment.

Taxpayer represents that both the REIT Merger and the Partnership Merger are properly treated as "a transfer of an interest in a partnership" within the meaning of § 743(b). Taxpayer represents that Acquirer intends to cause Taxpayer to make an election under § 754 effective for its taxable year that includes the Mergers. Therefore,

Taxpayer also represents that Acquirer will be entitled to a special basis adjustment with respect to Taxpayer's property pursuant to § 743(b).

LLC has claimed accelerated depreciation (including, in certain cases bonus depreciation) to the extent allowable on its assets. LLC has recorded an ADFIT liability balance consistent with the normalization method of accounting, which reduces its regulatory rate base. Immediately prior to the consummation of the Mergers, LLC had an ADFIT liability balance of approximately j dollars.

Taxpayer makes the following additional representations. Any § 743(b) tax basis adjustments resulting from the Mergers and the depreciation of those adjustments will not change or otherwise impact LLC's public utility property for ratemaking purposes and will not be associated with LLC's cost of service, rate of return ratemaking. Also, neither the Mergers nor the § 743(b) basis adjustments will result in any adjustment to the net book value of, or ADFIT liability attributable to, such property on LLC's (or Taxpayer's) regulatory books of account maintained in accordance with Generally Accepted Accounting Principles ("GAAP") applied to regulated utilities.

RULING REQUESTED

Taxpayer requests a ruling that no violation of the Normalization Rules of § 168(i)(9) and § 1.167(l)-1 will occur if the Taxpayer does not adjust the existing ADFIT balances to account for the consequences of any § 743(b) basis adjustments resulting from the Mergers.

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.

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 § 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 that has the power to approve such rates, even if the regulatory body has taken no action on the filed schedule or generally leaves undisturbed rates filed.

The regulations under former § 46, specifically § 1.46-3(g)(2), expand the definition of regulated rates. The expanded definition embodies the notion of rates established or approved on a rate of return basis. This notion is not specifically provided for in the regulations under former § 167. Nevertheless, 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. Thus, for purposes of applying the normalization rules, the definition of public utility property is the same for purposes of the investment tax credit and depreciation.

Former § 167(l) generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former § 167(l)(3)(G) in a manner consistent with that found in § 168(i)(9)(A). Section 1.167(l)-1(a)(1) provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under § 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

In order to use a normalization method of accounting, § 168(i)(9)(A)(i) requires a taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation for property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under § 168(i)(9)(A)(ii), if the amount allowable as a deduction under § 168 differs from the amount that would be allowable as a deduction under § 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under § 168(i)(9)(A)(i), then the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) provides that one way the requirements of § 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under § 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under § 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base (hereinafter referred to as the "Consistency Rule").

In order to satisfy the Consistency Rule, there must be consistency in the treatment of costs for rate base, regulated depreciation expense, tax expense, and deferred tax revenue purposes. The normalization rules would be violated if the federal income tax component of cost of service reflected depreciation of Taxpayer's costs that are not included in rate base or the depreciation component of cost of service.

Based on the foregoing, we conclude that no violation of the Normalization Rules of § 168(i)(9) and § 1.167(l)-1 will occur if the Taxpayer does not adjust the existing ADFIT balances to account for the consequences of any § 743(b) basis adjustments resulting from the Mergers. This ruling is expressly conditioned upon Taxpayer's representation that any § 743(b) tax basis adjustments resulting from the Mergers and the depreciation of those adjustments will not change or otherwise impact LLC's public utility property for ratemaking purposes and will not be associated with LLC's cost of service, rate of return ratemaking.

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 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 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,

David A. Selig
Senior Counsel, Branch 6
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

cc: