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Refer Reply To:
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Date:
May 06, 2021

Re:

LEGEND:

Taxpayer =

Parent =

HoldCo =
Commission A =
Commission B =
Operator =
State =
a =
b =
c =
d =
Date 1 =
Date 2 =
Year A =
Year B =
Director =

Dear :

This letter responds to your request, dated August 18, 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. In each of these regulatory jurisdictions, Taxpayer's rates are generally established on a cost-of-service, rate-of-return basis.

On Date 1, Parent announced Taxpayer's plans to acquire and advance a megawatts of solar in b mostly rural counties in State. On Date 2, Taxpayer filed with Commission A an application for a certificate of authority to acquire, construct, own, and operate b solar electric generation facilities (Facility or Facilities) and an application for approval of affiliated interest agreements related to ownership and operation of such Facilities. The Facilities are expected to be placed in service between Year A and Year B. Taxpayer also expects that the Facilities will qualify for the investment tax credit.

As of the date of this ruling request, the assets related to each Facility were held in single-purpose, limited liability project companies (Developer ProjectCos), wholly owned by their respective developers. Taxpayer has executed purchase and sale agreements with the developers to acquire c percent of the membership interest in Developer ProjectCos. Thereafter, Taxpayer will dissolve the Developer ProjectCos and assume the assets of Developer ProjectCos.

Taxpayer will then organize a single-member limited liability company named HoldCo. HoldCo will be a disregarded entity for federal income tax purposes and will organize a set of limited liability companies (Project HoldCos). Each Project HoldCo will organize one or more single-member limited liability companies (ProjectCos) that will be disregarded entities for federal income tax purposes and will ultimately each own one of the Facilities.

HoldCo will enter into an agreement with one or more unrelated financial institutions (Partner) to sell a membership in each Project HoldCo to Partner. Upon mechanical completion, Taxpayer will sell the assets and liabilities of each Facility to the appropriate ProjectCo, which will trigger a commitment by Partner to contribute capital to each Project HoldCo. Each Project HoldCo will execute an LLC Agreement that will allocate cash and property distributions; profits, losses, and tax credits; and other rights/responsibilities between HoldCo and Partner. Each Project HoldCo will be treated as a partnership for federal income tax purposes, and each ProjectCo owning a Facility with be treated as a disregarded entity for federal income tax purposes and as part of a Project HoldCo (Project HoldCo and ProjectCo will hereinafter be collectively referred to as Partnership). Each Partnership will file for and is expected to receive market-based rate 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. From the date of commercial operation, each Partnership will sell electricity produced by its Facility directly to the wholesale electricity markets administered by Operator. Partnership will not sell power to Taxpayer and there will not be a power purchase agreement between Partnership and Taxpayer.

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 unrecovered 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. Cash distributions from the Partnership to Taxpayer will reduce cost of service recoverable from customers.

RULINGS REQUESTED

Taxpayer requested the following ruling:

- The Facilities owned by each Partnership are not public utility property under § 168(i)(10) and former § 46(f)(5) and, thus, each Partnership is not subject to the deferred tax normalization rules of § 168(i)(9) or the investment tax credit normalization rules of former § 46(f).
- The Facilities are not treated as public utility property owned by Taxpayer or Partner under § 168(i)(10) or § 1.167(l)-3(c) of the Income Tax Regulations.

LAW AND ANALYSIS

First Ruling

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.

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

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

Second Ruling

Section 1.167(l)-3(c) provides, in relevant part, 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 was made under § 761 to be excluded from partnership treatment, then section 167(l) shall be applied by treating the partners as directly owning the property in proportion to their partnership interests. Therefore, § 1.167(l)-3(c) first considers whether such property is public utility property at the partnership level. If not, it then considers whether such property would be public utility property at the partner level, but only if the partnership is of a type that the partners are eligible to elect out of partnership treatment under § 761.

As discussed above with respect to the first ruling request, the Facilities are not considered public utility property in the hands of the Partnerships. In addition, Taxpayer represents that Taxpayer and Partner are ineligible under § 761 to elect out of partnership treatment. The inability of Taxpayer and Partner to make such an election removes the Facilities from § 1.167(l)-3(c) consideration in the hands of Partner and Taxpayer. Accordingly, based solely on Taxpayer's representations, we conclude that

the Facilities are not treated as public utility property owned by Taxpayer or Partner under § 168(i)(10) or § 1.167(l)-3(c).

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 the Partnerships will be respected as partnerships for federal income purposes nor provided partnership agreements for Partnerships. Accordingly, nothing in this letter should be construed as providing a ruling or other determination that the Partnerships will be respected as partnerships or that any purported owner will be respected as a partner 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
Senior Technician Reviewer, Branch 6
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

cc: