Internal Revenue Service

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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
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PLR-112343-21

Date:
November 29, 2021

Re:

LEGEND:

P	=
S1	=
S2	=
S3	=
S4	=
Company	=
Commission A	=
Commission B	=
State A	=
State B	=
State C	=
a	=
b	=
c	=
d	=
e	=
Bill	=
Facility A	=
Facility B	=
Location	=

Date =
Year A =
Year B =
Year C =

Dear :

This letter responds to your request, dated May 28, 2021, for a ruling regarding certain federal income tax consequences under § 168(i)(10) and former § 46(f) of the Internal Revenue Code of the proposed transactions described below. The relevant facts as represented in your submission are set forth below.

FACTS

S1 and S2 (hereinafter S1 and S2 will collectively be referred to as Taxpayer), State A corporations, are public utilities serving retail electric customers in State A. Taxpayer is wholly owned by S3, a State A energy holding company. S3 is wholly owned by Company, a State B limited liability company that is disregarded for federal income tax purposes and wholly owned by S4, a State C corporation. S4 is a percent owned by P, a State B corporation. P and its affiliated group of corporations, including Taxpayer, S3, and S4, file a consolidated federal income tax return on a calendar year basis using the accrual method of accounting.

Taxpayer is subject to regulation by Commission A and Commission B (Commissions) for ratemaking purposes. The Commissions generally establish Taxpayer's rates based on the costs to provide regulated electric service, including a return on investment. Taxpayer's rates, as established by Commission A, include two basic rate elements. The first, is a base tariff general rate determined on a cost-of-service basis. The base tariff general rate revenue requirement includes, among other costs, a return on the value of property dedicated to servicing the public. The second, is a base tariff energy rate that reflects the actual cost of purchased fuel, purchased power, and related expenses.

State A law requires Taxpayer to procure renewable energy to meet State A's renewable energy portfolio standard. Section 6 of Bill has the following key provisions: 1) Commission A may establish a "just and reasonable" price for the energy produced by a REF owned by a utility by reference to a competitive market price, without regard or reference to the principles of cost of service or rate of return price setting; and 2) any capital investment associated with the REF must be excluded from the utility's rate base and expenses associated with such REF must be excluded from the utility's revenue requirement.

Pursuant to the requirements of Section 6 of Bill, Taxpayer intends to acquire Facility A and Facility B (Facilities). S1 will own b percent and S2 will own c percent of each of the Facilities. The Facilities are both located at Location. Facility A is a d-megawatt

solar electric generating facility. Facility A is expected to begin commercial operation in late Year A or early Year B. Facility B is a e-megawatt solar electric generating facility. Facility B is expected to go into commercial operation in Year B. The Facilities have obtained their respective interconnection agreements with the transmission provider. A portion of Facility A has substantially completed its permitting requirements at the federal, state, and local level. Permit applications are pending for Facility B and the remaining portion of Facility A. All permitting for the Facilities is expected to be concluded by the end of Year C.

Taxpayer represents that the Facilities will satisfy the requirements of Section 6 of Bill. Facility A's and Facility B's capital investment and costs associated with the Facilities were never included in (and will be permanently excluded from) Taxpayer's rate base and revenue requirements. The revenue to Taxpayer for the renewable energy produced by the Facilities will be the price charged to customers based on competitive market rates and will not be based on cost-of-service or rate-of-return ratemaking principles.

RULINGS REQUESTED

Taxpayer requested the following rulings:

(1) Facility A, as a REF that satisfies the requirements of Section 6 of Bill, will not be public utility property within the meaning of former § 46(f) (of continuing applicability by virtue of § 50(d)(2), § 168(i)(10) and the regulations promulgated thereunder.

(2) Facility B, as a REF that satisfies the requirements of Section 6 of Bill, will not be public utility property within the meaning of former § 46(f) (of continuing applicability by virtue § 50(d)(2), § 168(i)(10) and the regulations promulgated thereunder.

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.

Taxpayer will predominantly use Facility A and Facility B in the trade or business of the furnishing or sale of electric energy. Therefore, Facility A and Facility B will meet the first requirement. In addition, Taxpayer is a regulated public utility company subject to the jurisdiction of federal and state law, including the ratemaking jurisdiction of Commission A. Therefore, Facility A and Facility B will also meet the second requirement.

However, as described above, the rates Taxpayer charges for electricity to be produced by Facility A and Facility B will be the rates determined to be “just and reasonable” by reference to competitive market prices through the program established under Section 6 of Bill. These rates will be the only source of compensation to Taxpayer for electricity produced by Facility A and Facility B. The process outlined in Section 6 of Bill by which Taxpayer can charge rates to State A customers does not include recovery of Taxpayer’s costs on a cost-of-service, rate-of-return basis, and all costs, including any capital investments, of Facility A and Facility B will be permanently excluded from Taxpayer’s rate base and revenue requirements. Thus, the program provided under Section 6 of Bill cannot be characterized as rate-of-return price setting. Therefore, Facility A and Facility B will not meet the third requirement.

Accordingly, we conclude that:

(1) Facility A, as a REF that Taxpayer represents satisfies the requirements of Section 6 of Bill, will not be public utility property within the meaning of former § 46(f) (of continuing applicability by virtue of § 50(d)(2), § 168(i)(10) and the regulations promulgated thereunder.

(2) Facility B, as a REF that Taxpayer represents satisfies the requirements of Section 6 of Bill, will not be public utility property within the meaning of former § 46(f) (of continuing applicability by virtue § 50(d)(2), § 168(i)(10) and the

regulations promulgated thereunder.

Except as specifically 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). In addition, no opinion is expressed concerning whether Taxpayer is the owner of the facilities generating electricity 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 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 a ruling, it is subject to verification on examination.

This letter is being issued electronically in accordance with Rev. Proc. 2020-29, 2020-21 I.R.B. 859. A paper copy will not be mailed to Taxpayer.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative. We are also sending a copy of this letter to the LB&I Policy Office.

Sincerely,

Jennifer A. Records
Senior Technician Reviewer, Branch 6
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure:
Copy for § 6110 purposes

cc: