Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
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PLR-105208-22

Date:
August 31, 2022

Re:

Legend

Taxpayer	=
Parent	=
Date 1	=
Date 2	=
State	=
Location	=
Facility	=
Commission A	=
Commission B	=
Operator	=
Operator Tariff	=
Developer	=
Project Company	=
Solar JV	=
a	=
b	=
c	=
d	=

Dear :

This letter responds to a letter dated Date 1, submitted on behalf of Taxpayer by its authorized representatives, requesting a ruling regarding the application of Internal Revenue Code (Code) § 168(i)(10) and former Code § 46(f) to the relevant facts as represented in Taxpayer's submission and subsequent correspondence that are set forth below.

Background and Facts

Taxpayer is a State corporation that is wholly owned by Parent, also a State corporation. Parent is the parent company of a group of corporations, including Taxpayer, that files a consolidated federal income tax return. Parent electronically files a consolidated federal tax return on a calendar year basis using the accrual method of accounting.

Taxpayer has a generating capacity of a megawatts. Taxpayer provides power for electric and natural gas customers in State. Taxpayer is regulated by Commission A, and is a member of the Operator. The Operator is a nonprofit organization created in compliance with Commission B's regulations to provide transmission services and operate markets for energy, capacity and ancillary services, thereby improving the flow of electricity in the regional marketplace and improving reliability. Taxpayer is qualified as a as that term is defined in the Operator's Tariff. As a , Taxpayer executed a with the Operator, confirming Taxpayer's agreement to be governed by the terms and conditions of the Operator's Tariff.

As part of its plan to replace a substantial portion of its existing electric generating fleet, Taxpayer intends to invest in solar projects, including the Facility. The Facility will consist of a b photovoltaic solar-powered electric generating facility in Location. These solar projects are intended to qualify for investment tax credits under § 48 of the Code.

The Facility will be developed by Developer, an independent third party, through Project Company, which is a disregarded entity of Developer for federal income tax purposes. Solar JV, currently a wholly-owned subsidiary of Taxpayer, entered into a Build Transfer Agreement with Developer on Date 2, to acquire c percent of the interest in Project Company.

Taxpayer and Tax Equity Investor, an independent investor, will enter into a joint venture to own Project Company, converting Solar JV to an entity treated as a partnership for federal income tax purposes. Taxpayer and Tax Equity Investor will each contribute cash to Solar JV. Taxpayer represents that at a future date, Taxpayer

will have the option to purchase all of Tax Equity Investor's interests in Solar JV for fair market value and if the option is exercised, Taxpayer will then own c percent of Solar JV.

Upon mechanical completion of the Facility, Developer will sell c percent of its membership interests in the Project Company to Solar JV, which will be treated as a purchase and sale of the Facility assets for federal income tax purposes. After the sale, Solar JV will be the sole owner of Project Company, and Project Company will be disregarded as separate from Solar JV for federal income tax purposes.

Developer will ensure that Project Company files for, and receives, market-based rate authority from Commission B, thus allowing Project Company to make sales of electricity, capacity, and ancillary services at market-based rates, rather than through rates established by rate-of-return ratemaking or cost-of-service ratemaking.

Project Company will sell all the energy from the Facility to Operator on a merchant basis at prices established in the Operator market (Operator Price). Taxpayer and Project Company will enter into a contract for differences (CFD), pursuant to which: (1) Taxpayer would be obligated to pay Project Company the difference in price if the fixed price set forth in the contract (Fixed Price) exceeds the Operator Price; and (2) Project Company would be obligated to pay Taxpayer the difference in price if the Operator Price exceeds the Fixed Price. Taxpayer will not take physical delivery of the energy from the Facility while the CFD is in effect. The "Fixed Price" will be determined based upon the expected fair market value for the sale of power at the time the Facility is to be placed in service. A third-party expert will be engaged to perform this evaluation based on relevant data for the Operator's sales. The purpose of the CFD is to provide an economic hedge for the Facility such that regardless of the prevailing market rates at the trading point, Project Company will essentially receive a fixed sales price for the generation of energy from the Facility.

Concurrently with the sale of electricity from Project Company to the Operator markets, Taxpayer represents that it will purchase electricity from the Operator's energy wholesale market to satisfy its obligations to its retail customers. Taxpayer represents that it will pass the cost of this electricity it purchases from the Operator markets directly to its customers at a rate approved by Commission A.

Taxpayer represents that it anticipates Commission A would provide an order permitting Taxpayer's investment in Solar JV to be included in its rate base, which would allow Taxpayer to recover its investment over an estimated d years, as well as a receive a return on its investment in Solar JV. Taxpayer further represents that it anticipates that the disposition and acquisition of Project Company and its jurisdictional assets to Solar JV will require approval from Commission B, and Commission B may also address any affiliate transactions between Taxpayer and Solar JV if the parties deem such approval is required.

Rulings Requested

Taxpayer requests the following rulings:

1. The Facility will not be public utility property under section 168(i)(10), and, therefore, related depreciation deductions and investment tax credits will not be subject to the normalization rules of § 168(i)(9) or former section 46(f); and
2. Neither Taxpayer nor Tax Equity Investor are subject to the tax normalization rules of § 168(i)(9) nor former § 46(f) as a result of their interests in Solar JV or the related transactions described herein.

Law and Analysis

Section 168(f)(2) of the Code 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) of the Code 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 the same. 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)) contain an expanded definition of regulated rates in § 1.46-3(g)(2)(iii). 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.

Project Company will predominantly use the Facility in the trade or business of the furnishing or sale of electric energy. Therefore, the Facility will meet the first requirement. In addition, the sales of electricity from the Facility by Project Company will be under the jurisdiction of Commission B. Therefore, the Facility will also meet the second requirement.

As described above, Project Company will sell electricity produced from the Facility to the Operator at rates established under the market-based rate authority of Commission B (not on a cost-of-service or rate-of-return basis). Therefore, the Facility will not meet the third requirement.

Accordingly, we conclude that:

1. The Facility will not be public utility property under § 168(i)(10), and therefore, related depreciation deductions and investment tax credits will not be subject to the normalization rules of § 168(i)(9) or former § 46(f).

2. Neither Taxpayer nor Tax Equity Investor are subject to the tax normalization rules of § 168(i)(9) nor former § 46(f) as a result of their interests in Solar JV or the related transactions described herein.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter (including other subsections of § 168). Specifically, Taxpayer has not requested a ruling regarding whether Solar JV will be respected as a partnership for federal income purposes nor provided a partnership agreement for Solar JV. Accordingly, nothing in this letter should be construed as providing a ruling or other determination that Solar JV will be respected as a partnership or that any purported owner will be respected as a partner of Solar JV for federal income tax purposes. In addition, no opinion is expressed concerning whether Solar JV is eligible to elect out of partnership treatment under § 761.[1]

This ruling is directed only to the taxpayer requesting it. We note that, while we have concluded that Tax Equity Investor is not subject to either the deferred tax or ITC normalization rules under the facts described above, no person may legally rely on a ruling not issued to that person. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. The rulings contained in this letter are based upon information and representations submitted on behalf of 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.

[1]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 §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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

/s/

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

cc: