

Internal Revenue Service

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Department of Treasury

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CC:DOM:P&SI:5 - PLR-113900-98

Date: November 3, 1998

Legend:

Taxpayer =

City X =

County Y =

State Z =

Project =

Department =

Commission 1 =

Commission 2 =

Board =

Resolution =

Road =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

l =

m =

n =

o =

p =

q =

r =

s =

t =

u =

v =

Dear :

This letter responds to your authorized representative's letter dated July 12, 1998, requesting a letter ruling concerning whether amounts paid by County Y to Taxpayer in connection with the design, construction, and installation of underground power lines are nonshareholder contributions to capital excludable from income under § 118(a) of the Internal Revenue Code. This letter is supplemented by another letter from your authorized representative dated October 21, 1998.

Taxpayer represents that the facts are as follows:

FACTS:

Taxpayer is an investor-owned, regulated public utility company organized and existing under the laws of State Z. Taxpayer is subject to the audit jurisdiction of the District Director in City X. Taxpayer is engaged principally in the business of electrical generation and distribution, providing service to over a customers in southern State Z. As a public utility, Taxpayer is regulated by Commission 1 and Commission 2.

Road is a major urban arterial b roadway which carries c lanes of traffic through d. The Project is located on Road between e and f and crosses g. The major economic engine for County Y is h which hosts i visitors each year. Within the Project limits, Road provides a major b commuter route and a principal access to several major j properties. Taxpayer owns major power facilities immediately adjacent to Road including numerous tubular steel poles with electric lines k to l in height on large concrete foundations. The poles and lines extend from e, across g, to two power substations east of f. These facilities are either located on private property within easements owned by Taxpayer or cross public rights-of-way owned by Department or County Y.

The owners of m approached County Y and requested that it form a special improvement district to finance a project to remove the overhead facilities and construct underground facilities to replace the overhead and at-grade facilities (the Project). County Y then asked each property owner located along the utility lines to be placed underground if they would support the Project. All but n of the property owners supported the Project.

The relocation of these overhead facilities to underground will be an aesthetic benefit to the community and promote public safety. In addition to the aesthetic benefits, the properties will benefit from the removal of these intrusive overhead facilities. Due to the relocation, some easement restrictions will be lessened. For example, after the relocation, o could build a p on their property which is currently restricted to only n stories beneath the lines. m would have better access to its property which could allow m to change its q and use the additional land for r. Furthermore, after the easement restrictions are lessened, s could be connected to t.

County Y determined through Resolution adopted by the Board on u that the

interest of County Y requires the acquisition and improvement of an underground conversion to provide the Project. The Project will be created under the applicable State Z statutory provisions.

State Z statute sets forth the State Z legislature's declaration that underground conversions serve a public purpose and reads as follows:

The legislature finds that in many areas of this state owners of real property, counties, cities and public utility corporations desire to construct new underground electric and communication services and to convert existing overhead electric and communication facilities to underground locations by establishing underground service districts for the purpose of effecting such construction or conversion. The legislature declares that a public purpose will be served and that the public welfare will be promoted by providing a procedure to accomplish such construction or conversion and that it is in the public interest to provide for such construction or conversion as provided in this chapter.

Under the terms of Resolution and the applicable State Z statute, Taxpayer as the "service provider" will relocate the overhead electrical transmission lines on Road between e and f underground primarily beneath Road.

As the scope of the Project is limited to a relocation, no new service facilities will be provided, nor will any increase in electrical capacity result from the proposed Project.

State Z statute and Resolution require that County Y and the service provider (Taxpayer) enter into an agreement whereby the service provider would provide the design and construction of the Project. County Y would finance the Project through a special improvement district, whereby property owners who realize a benefit from the Project's construction are assessed a proportionate share of the Project costs based upon such benefit. The Project cost is currently estimated at v.

Taxpayer also represents that the characteristics described below are present with respect to the contemplated contributions to Taxpayer. Taxpayer will receive title to all removed/relocated and newly installed power facilities paid for by County. This suggests a permanent inclusion in the working capital of Taxpayer. The payments to Taxpayer will not be for new services, nor will they be a prerequisite to the provision of services. Taxpayer and County Y will negotiate the relocation costs under an agreement; as such, Taxpayer will bargain for the assets being transferred. Finally, under an agreement between Taxpayer and County Y, Taxpayer will obtain full title and all other benefits of ownership associated with the resulting utilities facilities, and these facilities will be utilized by Taxpayer to produce income.

RULING REQUESTED:

Taxpayer requests the Internal Revenue Service to rule that the amounts paid by

County Y to Taxpayer in connection with the design, construction, and installation of the underground power lines represents a contribution to capital of Taxpayer under § 118(a) and are not contributions in aid of construction (CIAC) under § 118(b) of the Code.

LAW AND ANALYSIS:

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 for purposes of subsection (a), except as provided in subsection (c), the term “contribution to the capital of taxpayer” does not include any CIAC or any other contribution as a customer or potential customer.

Section 1.118-1 of the Income Tax Regulations provides, in part, that § 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 enabling the corporation to expand its operating facilities. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid to induce the taxpayer to limit production.

The legislative history to § 118 indicates that the exclusion from gross income for nonshareholder contributions to capital of a corporation was intended to apply to those contributions that are neither gifts, because the contributor expects to derive indirect benefits, nor payments for future services, because the anticipated future benefits are too intangible. The legislative history also indicates that the provision was intended to codify the existing law that had developed through administrative and court decisions on the subject. H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 17 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 18-19 (1954).

In general, the amendment made by § 824 of the Tax Reform Act of 1986 (the 1986 Act) to § 118 was intended to require a regulated public utility to include in income the value of any CIAC made to encourage the provision of services by the utility to a customer. As a result under the 1986 Act, all CIACs, even those received by a regulated public utility such as Taxpayer, are includable in the gross income of the receiving corporation. The House Ways and Means Committee Report (House Report) states that property, including money, is a CIAC, rather than a contribution to capital, if it is contributed to provide or encourage the provision of services to or for the benefit of the person making the contribution. H.R. Rep. No. 426, 99th Cong., 1st Sess. 644 (1985), 1986-3 (Vol. 2) C.B. 644.

A utility is considered as having received property to encourage the provision of services if any one of the following conditions are met: (1) the receipt of the property is a prerequisite to the provision of the services; (2) the receipt of the property results in the provision of services earlier than would have been the case had the property not

been received; or (3) the receipt of the property otherwise causes the transferor to be favored in any way. The House Report also states that the repeal of the special exclusion does not affect transfers of property that are not made for the provision of services, including situations where it is clearly shown that the benefit of the public as a whole was the primary motivating factor in the transfers. H.R. Rep. No. 426, 99th Cong., 1st Sess. 644-45 (1985), 1986-3 (Vol. 2) C.B. 644-45.

Notice 87-82, 1987-2 C.B. 389, provides additional guidance on the treatment of CIACs. Notice 87-82 follows the language from the House Report and states that a payment received by a utility that does not reasonably relate to the provision of services by the utility or for the benefit of the person making the payment, but rather relates to the benefit of the public at large, is not a CIAC. In Notice 87-82, an example of a payment benefitting the public at large is a relocation payment received by a utility under a government program to place utility lines underground. In that situation, the relocation is undertaken for either reasons of community aesthetics or in the interest of public safety and does not directly benefit particular customers of the utility.

In Brown Shoe Co. v. Commissioner, 339 U.S. 583 (1950), 1950-1 C.B. 38, the Court held that money and property contributions by community groups to induce a shoe company to locate or expand its factory operations in the contributing communities were nonshareholder contributions to capital. The Court reasoned that when the motivation of the contributors is to benefit the community at large and the contributors do not anticipate any direct benefit from their contributions, the contributions are nonshareholder contributions to capital. 339 U.S. at 591, 1950-1 C.B. at 41.

In United States v. Chicago, Burlington & Quincy Railroad Co., 412 U.S. 401, 413 (1973), the Court articulated five characteristics of a nonshareholder contribution to capital. First, the payment must become a permanent part of the transferee's working capital structure. Second, it may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee. Third, it must be bargained for. Fourth, the asset transferred foreseeably must benefit the transferee in an amount commensurate with its value. Fifth, the asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect.

In the instant case, the special improvement district authorized by County Y Resolution will be formed pursuant to State Z law that encourages undergrounding overhead utility lines. The State Z law makes clear that undergrounding electric facilities will serve a public purpose. In addition, the undergrounding will not directly benefit any customers of Taxpayer in their capacity as customers. Accordingly, we conclude that the contributions to Taxpayer for the relocation fall within the public benefit exception described in the House Report and Notice 87-82. Furthermore, the contributions to Taxpayer meet the five characteristics of a nonshareholder contribution to capital stated in United States v. Chicago, Burlington & Quincy Railroad Co.

Applying the relevant law to the facts and representations of Taxpayer, we rule as follows:

The amounts received by Taxpayer from County Y in connection with the design, construction, and installation of the underground power lines are contributions to the capital of Taxpayer under § 118(a) of the Code.

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.

In accordance with the power of attorney filed with this request, we are sending copies of this letter ruling to your authorized representative.

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.

Sincerely yours,

Walter H. Woo
Senior Technician Reviewer
Branch 5
Office of Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosure: 6110 copy