Internal Revenue Service

Number: **200048026**
Release Date: 12/1/2000
Index: 118.01-02

Department of the Treasury

P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:5 — PLR-110197-00
Date:
August 30, 2000

Legend:

Taxpayer =

State =
Commission =
Company =

School District =
City =
District =
State Code =
Foundation =
Project =
Line A =
Line B =
a =

Dear :

This letter responds to your authorized representative's letter dated May 15, 2000, requesting a letter ruling concerning whether the payment received by Taxpayer for the relocation of certain underground gas transmission lines is a nonshareholder contribution to capital excludable from income under § 118(a) of the Internal Revenue Code.

Taxpayer represents that the facts are as follows:

FACTS:

Taxpayer is an investor-owned public utility incorporated in State. Taxpayer provides natural gas transmission and distribution services to customers in southern and central State. Taxpayer is subject to the regulation of the Commission. Taxpayer is a wholly-owned subsidiary of Company, a State corporation, with whom it files a consolidated return on a calendar year basis using the accrual method of accounting. The District Office of the Internal Revenue Service that has or will have examination jurisdiction over Taxpayer is District.

The proposed grading and construction of a new public high school site for the School District requires the permanent relocation of two 1,800 foot sections of gas transmission pipeline (Gas Lines) which are owned and operated by Taxpayer. The State Code provides that the governing board of a school district shall not approve a project involving the acquisition of a school site by a school district unless it is determined that the property purchased or to be built upon is not a site that contains one or more pipelines, situated underground or aboveground, which carries, among other things, hazardous substances, unless the line is used to supply natural gas to that school or neighborhood.

The parcels of land that the Gas Lines cross are owned by the Foundation, and were the subject of a lease-option agreement with the School District. The option has been exercised by the School District and escrow has been opened to acquire the property for the construction of the Project. The Project will be constructed to alleviate present overcrowding in education facilities within the School District.

The Foundation is a tax-exempt non-profit organization organized under § 501(c)(4). The Foundation has been established with the sole purpose of providing land and funds for grades 7-12 school facilities for the benefit of those residing within the geographical boundaries of the School District.

The Project and the Gas Lines are situated in City. The exclusive purpose of the relocation of the Gas Lines is to facilitate construction of the Project. The Gas Lines, referred to by Taxpayer as Line A and Line B, are intrastate transmission pipelines. They are high pressure conduit pipelines that transport gas from one substation to another. The relocation is not a condition for service from the Gas Lines to the School District by Taxpayer. No customers are served from these lines. Accordingly, the Gas Lines will not supply natural gas to the proposed high school or the neighborhood.

The Foundation, on behalf of the School District, has paid Taxpayer $a for the cost to relocate the Gas Lines.

The Commission does not allow Taxpayer to add amounts received from the School District in Taxpayer's rate base for rate making purposes, rather the cost is treated as income. As a result, Taxpayer will not earn a return on the funds it receives from the School District to relocate the lines.

Taxpayer also represents that: (1) the relocated Gas Lines will remain a permanent part of Taxpayer's working capital structure; (2) the payment to Taxpayer is not compensation for services; (3) the payment is a bargained for exchange for the relocation project; (4) the payment will result in new and improved equipment as part of Taxpayer's natural gas transmission system commensurate with the amount of funds paid; and (5) the relocated Gas Lines will be utilized by Taxpayer in the course of its business to produce income.

RULING REQUESTED:

Taxpayer requests the Internal Revenue Service to rule that the payment received by Taxpayer for the relocation of the Gas Lines is a nonshareholder contribution to capital under § 118(a) and is not a taxable CIAC under § 118(b).

LAW AND ANALYSIS:

Section 61(a) and § 1.61-1 of the Income Tax Regulations provide that gross income means all income from whatever source derived, unless excluded by law. 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), as amended by § 824(a) of the Tax Reform Act of 1986 (the 1986 Act) and § 1613(a) of the Small Business Job Protection Act of 1996, 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 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 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 is 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 present case, the State Code prohibits the use of the proposed site to construct the Project unless the Gas Lines are removed from the site. It is clear that the State Code prohibition against underground or aboveground pipelines carrying, among other things, hazardous materials on a proposed school site promotes public safety. The relocation is mandated by statute and undertaken for purposes of public safety. Accordingly, we conclude that the payment to Taxpayer for the relocation falls within the public benefit exception described in the House Report and Notice 87-82, and will not be treated as a CIAC under § 118(b). Furthermore, the payment to Taxpayer meets the five characteristics of a nonshareholder contribution to capital stated in United States v. Chicago, Burlington & Quincy Railroad Co.

Based solely on the foregoing analysis and the representations made by Taxpayer, we rule as follows:

The payment received by Taxpayer for the relocation of the Gas Lines is a nonshareholder contribution to the capital of Taxpayer under § 118(a) and is not a CIAC under § 118(b).

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 Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: 6110 copy