Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
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Date:
January 23, 2020

Re:

LEGEND:

Taxpayer	=
Company	=
Commission A	=
Commission B	=
State	=
a	=
b	=
Date 1	=
Date 2	=
Director	=

Dear

This letter responds to your request for a ruling, submitted by your authorized representative, concerning the federal income tax consequences of the transaction described below.

BACKGROUND and FACTS

Company is a public utility organized and existing under the laws of State engaged in the business of rendering electric utility service in State and owns, operates, manages, and controls, among other things, plant and equipment in State used for the production, transmission, delivery, and furnishing of electric service to its customers in

State. Company is subject to the regulatory jurisdiction of Commission A and Commission B. Company is a wholly-owned indirect subsidiary of Taxpayer and a member of its affiliated group which files a consolidated federal income tax return on a calendar-year basis using the accrual method of accounting. For federal income tax purposes, Company is a disregarded entity.

On Date 1, Company filed a petition with Commission A, requesting approval of the voluntary solar energy services program, (Program), as an Alternative Regulatory Plan (ARP) under State law. In addition to seeking approval to use market derived pricing for solar energy services under the Program, Company sought an ARP in order to eliminate the need to file separate approval requests with Commission A for each solar facility constructed under the Program.

On Date 2, Commission A issued an order granting Company's request to implement the Program with some slight modifications. Under the order, the Company is required to file an annual report with Commission A containing additional information regarding the Program.

Under the Program, the Company will enter into a solar energy service agreement (Agreement) with a participating customer (Customer) for the provision of solar energy services with respect to a solar photovoltaic generation system (System) to be constructed and installed on the Customer's premises. The Company will own, operate, and maintain the System during the term of the Agreement. Pursuant to the terms of the Agreement, the Customer is entitled to a percent of the electrical energy generated by the System in exchange for a fixed monthly fee, which could include a fixed percentage price escalator.

Participation in the Program is voluntary and is limited to certain of the Company's commercial customers up to b megawatts of aggregate generating capacity. None of the costs of the solar facilities installed under the Program will be included in regulated rate base for purposes of determining the price for Solar Energy Service, or otherwise.

The Company will establish a market-based price for the solar energy services to be paid by each Customer through arm's-length negotiation, based on criteria that include, but are not limited to, an evaluation of the Customer's credit worthiness. Rates charged to Customers under the Program will be based on market-based prices for the particular solar facility that each participating Customer selects to match its individual needs.

RULING REQUESTED

Taxpayer has requested a ruling that the System will not be public utility property (PUP) within the meaning of § 168(i)(10) and former § 46(f)(5) of the Internal Revenue Code (Code) because the prices negotiated under the Agreement and Program approved by Commission A are not at a cost-of service based, rate-of-return price for the furnishing of electrical energy.

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 PUP, in relevant part, 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.

Prior to the Revenue Reconciliation Act of 1990, the definition of public utility property was contained in §167(l)(3)(A) and § 168(i)(10), which defined public utility property by means of a cross reference to § 167(l)(3)(A). The definition of PUP is unchanged. Section 1.167(l)-1(b) provides that under § 167(l)(3)(A), property is PUP 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.

Pursuant to Code §50(d)(2), rules similar to the rules of former Code §46(f) as in effect on November 5, 1990, continue to determine whether or not an asset is PUP for purposes of the investment tax credit normalization rules. As in effect at that time, former Code §46(f)(5) defined PUP by reference to former Code §46(c)(3)(B). Section 168(i)(l0) sets out the current definition of PUP for purposes of the depreciation normalization rules.

The definitions of PUP contained in § 168(i)(10) and former § 46(f)(5) are essentially identical. Section 1.167(l)-1(b) restates the statutory definition providing that

property will be considered PUP if it is used predominantly in a public utility activity and the rates are regulated. Section 1.167(l)-1(b)(1) provides that rates are regulated for such purposes if they are established or approved by a regulatory body. The terms established or approved are further defined to include the filing of a schedule of rates with the regulatory body which has the power to approve such rates even though the body has taken no action on the filed schedule or generally leaves undisturbed rates filed.

The regulations under former § 46, specifically § 1.46-3(g)(2), contain an expanded definition of regulated rates. This expanded definition embodies the notion of rates established or approved on a rate of return basis. In addition, there is a 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 PUP is the same for purposes of the investment tax credit and depreciation.

Accordingly, the key factors in determining whether property is PUP are that (1) the property 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.

Any facility in the Program, described above, will be predominantly used in the trade or business of the furnishing or sale of electric energy and therefore, it will satisfy the first key factor. Moreover, as a regulated public utility subject to the ratemaking jurisdiction of Commission A and Commission B, approval of the Program satisfies the second factor. However, the fees charged to Customers under the Program are negotiated based on market-based factors as well as considerations unique to each particular Customer and not determined on a cost-of-service basis.

Accordingly, we conclude that the System will not be PUP within the meaning of § 168(i)(10) and former § 46(f)(5).

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). Specifically, no opinion is expressed concerning whether the contract to sell electricity constitutes a

service contract under § 7701(e). In addition, no opinion is expressed concerning whether the Taxpayer is the owner of the System generating electricity for federal income tax purposes. Further, no opinion is expressed or implied on the classification of the property under § 168(e). Except as provided in § 168(e)(3), section 5.03 of Rev. Proc. 87-56, 1987-2 C.B. 674, provides, however, that asset classes in Rev. Proc. 87-56 include property described in such asset classes without regard to whether a taxpayer is a regulated public utility or an unregulated company.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives. We are also sending a copy of this letter to the Director.

Sincerely,

Patrick S. Kirwan
Chief, Branch 6
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

cc: