

Investment credit; facility jointly owned with city and cooperative. The portion of an electric generating facility owned by two investor-owned utilities as tenants in common with a municipally-owned utility and a tax-exempt cooperative may qualify as section 38 property.

ISSUE

Whether ownership by a municipally-owned utility or an electric cooperative exempt from tax under section 501(c)(12) of the Internal Revenue Code of 1954 of an interest in an electric generating facility disqualifies the entire facility as section 38 property by reason of the application of section 48(a)(4) or (5).

FACTS

An electric generating facility is owned as a tenancy in common under an arrangement classified as a partnership for Federal income tax purposes. There is no special allocation of partnership income, deductions, or credits among the partners. The participants are investor-owned utilities (Company M and Company X), a municipally-owned utility (the City), and a tax-exempt electric cooperative (the Cooperative). The respective interests of the participants are:

Company M	77 percent
Company X	15 percent
The City	4 percent
The Cooperative ...	4 percent

Each participant contributes its pro rata share of the amounts expended to build and operate the facility, and each is required to take in kind a share of the electricity produced by the facility corresponding to its percentage interest. Pursuant to an operating agreement among the parties, Company M will operate the facility on behalf of the participants. Pursuant to the agreement, Company M is paid an amount not in excess of the fair market value of its services. Any sales of electricity by one participant to another must be made at a fair market price for such electricity.

LAW

The applicable section of the Code is 48(a)(4) and (5).

Section 48(a) of the Code defines section 38 property. Section 48(a)(4) provides that property used by certain tax-exempt organizations shall be treated as section 38 property only if such property is used predominantly in an unrelated trade or business the income from which is subject to tax under section 511.

Section 48(a)(5) of the Code provides that property used by the United States, or by any State or political subdivision

thereof, shall not be treated as section 38 property.

HOLDING

Held, the interests of the Cooperative and of the City do not qualify as section 38 property by reason of the application of sections 48(a)(4) and 48(a)(5) of the Code, respectively.

Held further, the disallowance of the investment credit in respect of the interests of the Cooperative and of the City does not render the investments in the facility of Company M and Company X ineligible for the investment credit. Company M and Company X may claim the investment credit provided that they are otherwise entitled to the credit under applicable provisions of the Code and regulations.

The above conclusions apply whether title to the facility is in the partners as tenants in common or is in the partnership. The above conclusions also apply even though the partners have elected, pursuant to section 761(a), to be excluded from the application of subchapter K of the Code.