

Internal Revenue Service

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LEGEND

- Agency =
- Independent System Operator =
- State =
- Bonds =

Dear

This is in response to your representative’s request on behalf of the Agency for a ruling that the Agency’s becoming a member of the ISO will not be a deliberate action that causes the Bonds to be private activity bonds under § 141 of the Internal Revenue Code (the “Code”).

FACTS AND REPRESENTATIONS

The Agency is a political subdivision of the State whose thirty-two members are all municipalities. The Agency was created to permit its members to secure, by joint action among themselves, or by contract with other utilities, an adequate, reliable, and economical supply of electric power and energy. The Agency has the authority to finance, own, and operate electric generation, transmission and related facilities. The Agency issued the Bonds in part to refinance the acquisition of certain transmission and related facilities of the Agency (the “Transmission Facilities”). Currently, the Agency owns and operates the Transmission Facilities.

The electric industry is in the midst of significant changes to the way transmission services are purchased and sold as a result of the Energy Policy Act of 1992 and various orders of the Federal Energy Regulatory Commission (the “FERC”), including Order numbers 888 and 2000 (referred to as “open access”). A primary purpose of open access is to reduce consumers’ electricity costs by allowing consumers to choose from among the various providers of electricity and, therefore, to obtain the least expensive supply of electricity.

To achieve this purpose, the FERC in Order number 888 required, among other items, (1) the provision of open access transmission services on a non-discriminatory basis by all FERC-jurisdictional utilities that own, operate, or control interstate transmission facilities, and (2) that non-jurisdictional utilities which purchase transmission services from FERC-jurisdictional utilities must provide open access transmission service to the FERC-jurisdictional utilities under terms that are comparable to the service the non-jurisdictional utility provides itself. In Order number 2000, the FERC required, among other items, FERC-jurisdictional utilities to make certain filings with the FERC with respect to forming and participating in a regional transmission organization (an "RTO"), which includes independent system operators. Order number 2000 provides the required characteristics for RTOs such as independence, scope and regional configuration, operational authority, and short-term reliability.

The Agency is not subject to the jurisdiction of the FERC. Nonetheless, the regulatory changes have changed the marketplace for electricity transmission. In response to these changes, the Agency entered into an agreement (the "Agreement") with other transmission facilities owners to form the ISO, an independent system operator. When the Agreement becomes effective, the Agency will transfer operational control of the Transmission Facilities to the ISO. However, the Agency will retain ownership of the Transmission Facilities.

The ISO will provide non-discriminatory access to the transmission facilities of its members pursuant to an open access transmission tariff (the "Tariff"). Both the Agreement and the Tariff have been approved by the FERC as being consistent with its rules promulgated under §§ 205 and 206 of the Federal Power Act, 16 U.S.C. § 824d and 824e (2001).

The Agency represents that it will apply the provisions of § 1.141-7T(f)(5) of the temporary Income Tax Regulations to the Bonds.

LAW AND ANALYSIS

Generally, under § 103(a), gross income does not include interest on any state or local bond. Section 103(b)(1) provides that interest on a state or local bond is not excluded from gross income if the bond is a private activity bond which is not a qualified bond (within the meaning of § 141).

Section 141(a) defines the term private activity bond to mean any bond issued as part of an issue which meets either (1) the private business use test and the private security or payment test (the "private business tests"), or (2) the private loan financing test.

Section 141(b)(1) states that except as otherwise provided, an issue meets the private business use test if more than 10 percent of the proceeds of the issue are to be used for any private business use. Section 141(b)(2) provides that an issue meets the private security or payment test if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly (A) secured by any interest in property

used or to be used for a private business use, or in payments in respect of such property, or (B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

Section 141(b)(6)(B) defines private business use to mean use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. Section 141(b)(6)(A) provides that use as a member of the general public is not taken into account.

Section 1.141-2(d)(1) provides that an issue is an issue of private activity bonds if the issuer reasonably expects, as of the issue date, that the issue will meet either the private business use tests or the private loan financing test. Section 1.141-2(d)(1) further provides that an issue is also an issue of private activity bonds if the issuer takes a deliberate action, subsequent to the issue date, that causes the conditions of the private business tests or the private loan financing test to be met.

Section 1.141-7T(f)(5)(ii) provides that an action is not treated as a deliberate action under § 1.141-2(d) if it is taken to implement the offering of non-discriminatory, open access tariffs for the use of transmission facilities financed by an issue in a manner consistent with rules promulgated by the FERC under §§ 205 and 206 of the Federal Power Act (or comparable provisions of state law). Section 1.141-7T(f)(5)(ii) also provides that this exception does not apply to the sale, exchange, or other disposition of transmission facilities to a nongovernmental person. Section 1.141-15T(f)(1) provides that in general § 1.141-7T(f)(5) applies to bonds sold on or after January 19, 2001 that are subject to § 1301 of the Tax Reform Act of 1986, 1986-3 C.B. (Vol. 1) 1, 519. However, § 1.141-15T(i) provides that § 1.141-7T(f)(5) may be applied to any bonds.

We have not determined whether the Agency's entering into the Agreement will cause the private business tests or the private loan financing test to be met. Notwithstanding, we conclude that such action will not be treated as a deliberate action by the Agency with respect to the Bonds under § 1.141-2(d) because it is an action described in § 1.141-7T(f)(5)(ii). The Agency's action is being taken to implement the offering of non-discriminatory, open access tariffs for the use of transmission facilities financed by an issue in a manner consistent with the rules promulgated by the FERC under §§ 205 and 206 of the Federal Power Act. Furthermore, there is no sale, exchange, or other disposition of the Transmission Facilities by the Agency to a nongovernmental person.

CONCLUSION

The Agency's entering into the Agreement will not be treated as a deliberate action by the Agency with respect to the Bonds under § 1.141-2(d) because it is an action described in § 1.141-7T(f)(5)(ii).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury

statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings.

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. Specifically, no opinion is expressed as to whether the Bonds are tax-exempt under § 103.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer's representative.

Sincerely,
Assistant Chief Counsel
(Exempt Organizations/Employment Tax
Government Entities)
By: Bruce M. Serchuk
Senior Technician Reviewer,
Tax Exempt Bond Branch