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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B06
PLR-110019-20

Date:
May 04, 2021

Re:

LEGEND

Taxpayer	=
Company	=
Partnership	=
Facility	=
State A	=
State B	=
Commission 1	=
Commission 2	=
Statute	=
Clause	=
Month	=
Year	=
a	=

b =

c =

d =

Director =

Dear :

This letter responds to your request dated April 15, 2020, for a ruling regarding the application of Internal Revenue Code (Code) § 168(i)(10) and former § 46(f) to the facts described below. The relevant facts as represented in your submission are set forth below.

FACTS

Taxpayer, a State A corporation, is the parent company of a group of corporations (Group), the members of which include regulated natural gas and electric utility companies operating in a states. The Group files a consolidated federal income tax return on a calendar year basis using accrual methods of accounting. Company is a State B limited liability company wholly owned by Taxpayer and treated as a disregarded entity for federal income tax purposes. Company primarily operates as a natural gas and electric utility in State B and is regulated by Commission 1.

As part of its plan to replace a substantial portion of its coal-fueled electric generating fleet, Company intends to invest in and purchase electricity from solar projects. These projects are intended to qualify for investment tax credits with respect to energy property under § 48.

As of the date of this ruling request, Company expected to enter into a Build Transfer Agreement with an independent third party (Developer) in Month Year. Under the Build Transfer Agreement, Developer will develop the Facility.

Company and an independent investor (Tax Equity Investor) will enter into a joint venture by forming Partnership, a limited liability company, that will be treated as a partnership for federal income tax purposes. Company and Tax Equity Investor will each contribute cash to Partnership. Company will assign its rights, interests, and obligations under the Build Transfer Agreement to Partnership. Partnership will purchase the Facility from Developer.

The Facility will sell the energy generated directly to Company under either a wholesale power purchase agreement with a per megawatt hour charge or a fixed

monthly price charge (Service Agreement). The Service Agreement will have a term of at least b years and will constitute a wholesale contract under the jurisdiction of Commission 2. The Service Agreement will be subject to separate approval by Commission 2 because Partnership will be making wholesale sales of energy to Company. The Service Agreement will have to be separately approved under Commission 2's process (under Statute 1) for assessing the justness and reasonableness of an affiliate contract.

Prior to commencing sales pursuant to the Service Agreement, Partnership will obtain market-based rate authority from Commission 2, allowing it to make sales of electricity, capacity, and ancillary services at market-based rates, rather than cost-based rates with a regulated rate of return. Under the Service Agreement, Company will purchase c% of the electric output, capacity, and other marketable products or capabilities of the Facility. Prices under the Service Agreement will be determined on an arm's-length negotiated basis pursuant to market-based rate authority granted to Partnership by Commission 2 and will not be determined on a cost-of-service basis.

The Service Agreement will also be submitted to Commission 1 for approval because the costs associated with Company's contractual purchases will be passed through to Company's retail customers. The costs associated with the purchase of electricity from Partnership will be included in Commission 1 Clause as a pass through to Company customers. Company's sale of electricity to its retail customers will be subject to regulation by Commission 1, and Company's equity interest in Partnership will be included in its rate base. Commission 1 will not have jurisdiction over sales of electricity between Partnership and Company, however.

As it will purchase c% of the Facility's electrical power through the term of the Service Agreement, Company will make ongoing, periodic payments to Partnership pursuant to the Service Agreement. Partnership's profits, losses, cash, and investment tax credits will be allocated to Company and Tax Equity Investor in accordance with the LLC Agreement.

At a future date, Company will have an option to purchase all of Tax Equity Investor's interests in Partnership for fair market value in accordance with the terms of the LLC Agreement. If the option is exercised, Company will then own d% of Partnership.

The transactions described herein are contingent on Partnership receiving from Commission 2 both market-based authority for all of its sales of electricity, capacity, and ancillary services, as well as separate approval of the Service Agreement.

RULING REQUESTED

Taxpayer requests the following ruling:

To the extent power is sold from the Facility under the Service Agreement, the Facility will not be public utility property under § 168(i)(10), and therefore, related depreciation deductions and investment tax credits will not be subject to the normalization rules of § 168 or former § 46(f).

LAW AND ANALYSIS

Section 168(f)(2) 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) defines, in part, public utility property 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, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any state or political subdivision thereof.

Prior to the Revenue Reconciliation Act of 1990, § 168(i)(10) defined public utility property by means of a cross reference to § 167(l)(3)(A). Section 167(l)(3)(A) as then in effect contained the same definition of public utility property that is currently in § 168(i)(10). Section 1.167(l)-1(b) provides that under § 167(l)(3)(A), property is public utility property 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, even though such body has taken no action on the filed schedule or generally leaves undisturbed rates filed by the taxpayer.

The definitions of public utility property contained in § 168(i)(10) and former § 46(f)(5) are essentially the same. Pursuant to § 50(d)(2), rules similar to the rules of former § 46(f), as in effect on November 5, 1990, continue to determine whether an asset is public utility property for purposes of the investment tax credit normalization rules. As in effect at that time, former § 46(f)(5) defined public utility property by reference to former § 46(c)(3)(B).

The regulations under former § 46 (of continuing applicability by virtue of § 50(d)(2)) contain an expanded definition of regulated rates in § 1.46-3(g)(2)(iii). This expanded definition embodies the notion of rates established or approved on a rate-of-

return basis, where rate of return includes a fair return on the taxpayer's investment in providing such goods and services. Furthermore, rates are not "regulated" if they are established or approved on the basis of maintaining competition within an industry, insuring adequate service to customers of an industry, or charging "reasonable" rates within an industry. In addition to the definition in the § 46 regulations, there is an expressed 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 the application of the normalization rules, the definition of public utility property is the same for purposes of the investment tax credit and depreciation.

Thus, under both the depreciation and the investment tax credit normalization rule definitions, a facility must meet three requirements to be considered public utility property:

1. It 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.

The Facility will meet the first requirement as it will be used predominantly in the trade or business of the furnishing or sale of electrical energy. The Facility will also meet the second requirement as it will be subject to the jurisdiction of Commission 2.

The Facility will not meet the third requirement because Partnership will use the Facility to sell the power the Facility generates at rates established on a market basis (and not on a rate-of-return or cost basis) under the wholesale Service Agreement. Such sales will be regulated by Commission 2 under market-based rates. Commission 1 will not be able to influence the contractual rates that Company will pay for electricity from the Facility as sales between Partnership and Company will not be subject to its jurisdiction.

Accordingly, we conclude that:

To the extent power is sold from the Facility under the Service Agreement, the Facility will not be public utility property under § 168(i)(10), and therefore, related depreciation deductions and investment tax credits will not be subject to the normalization rules of § 168 or former § 46(f).

Except as explicitly 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, Taxpayer has not requested a ruling regarding whether Partnership will be respected as a partnership for federal income tax purposes nor provided a final partnership agreement for Partnership. Accordingly, nothing in this letter should be construed as providing a ruling or other determination that Partnership will be respected as a partnership or that any purported owner will be respected as a partner of Partnership for federal income tax purposes. In addition, no opinion is expressed concerning whether Partnership is eligible to elect out of partnership treatment under § 761 or whether the Service Agreement constitutes a service contract under § 7701(e).

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. This ruling is based upon information and representations submitted on behalf of Taxpayer and accompanied by penalties of perjury statements executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification upon examination.

In accordance with the power of attorney on file with this office, copies of this letter are being sent to your authorized representatives. We are also sending a copy of this letter to Director.

Sincerely,

Jennifer A. Records
Senior Technician Reviewer, Branch 6
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

cc: