

Private Letter Rulings

Private Letter Ruling 8537063, IRC Sec(s). 46

UIL No. 0046.07-02

Headnote:**Reference(s):** Code Sec. 46;

Private Letter Ruling 8537063

Code Sec. 46 INVESTMENT CREDIT -- utilities .

State public electric utility (Co. M)'s rates are subject to regulatory authority of Commission (C-1) and C-2. M "normalizes" depreciation and investment credit as to its regulated books of account and for purposes of establishing its cost of service for rate-making purposes. For property placed in service after 1980, normalization method employed by M complies with requirements of Sec. 168(e)(3) M has elected to normalize its investment credits by use of Sec. 46(f)(2) M and Lessor (L) entered into safe harbor lease Agreement under Sec. 168(f)(8) under which M sold to and leased back from L undivided interest in Property. "Original Cash Payment" of b (net proceeds of sale) was made to M. M filed proposed tariff for rate increase with C-1 that included proposed regulatory treatment of Original Cash Payment of b. M proposed to amortize net proceeds of sale as reduction of cost of service over 38-year life of Property without providing for rate base reduction. As part of its temporary order (X), C-1 required that net proceeds be deducted from rate base and that depreciable basis of Property be reduced by net proceeds for rate-making purposes. C-1 later issued Y order granting M's motion for rehearing on issue of proper rate-making treatment of Agreement. RULED: Last sentence of Sec. 168(f)(8)(D) added by P.L. No. 97-448, as in effect prior to P.L. No. 97-248, is applicable to Agreement. Agreement entered into between M and L isn't agreement as to qualified leased property under Sec. 168(f)(8) if C-1's temporary rate order becomes final.

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Full Text:

This is in response to the letter of September 10, 1984, submitted on your behalf in which a ruling was requested on behalf of the taxpayer Company named above. The following representations were furnished with the ruling request. The Company is a State A public electric utility whose rates are subject to the regulatory authority of the Commission and the Federal Energy Regulatory Commission. The Company "normalizes" depreciation and investment credit with respect to its regulated books of account, and for purposes of establishing its cost of service for ratemaking purposes. For property placed in service after 1980, the normalization method employed by the Company complies with the requirements of section 168(e)(3) of the Internal Revenue Code. The Company has elected to normalize its investment credits by use of section 46(f)(2) of the Code. On a, the Company and Lessor entered into a safe harbor lease agreement (Agreement) under section 168(f)(8) of the Code, under which the Company sold to and leased back from the Lessor an undivided interest in the Property. Under the Agreement, an "Original Cash Payment" of b was made to the Company.

On c the Company filed a proposed tariff for a rate increase with the Commission that included a proposed regulatory treatment of the Original Cash Payment of b (referred to by the Commission as "net proceeds of the sale"). The Company proposed to amortize the net proceeds of the sale, as a reduction of cost of service, over the 38-year life of the Property without any provision for rate base

reduction. The Company's position reflected, in part, its concern that a rate base reduction under these circumstances might result in a disallowance of the tax credits otherwise available with respect to the Property, thereby subjecting the Company to potential liability to the Lessor under section 5(a)(xi) of the Agreement.

As part of its X Order ("temporary order"), the Commission required that the net proceeds of the sale be deducted from rate base and that the depreciable basis of the Property be reduced by the net proceeds of the sale for ratemaking purposes. The Commission took the view that these funds, in the amount of b, were supplied to the Company at "zero cost." As a result, the Commission concluded that the proceeds received pursuant to the Agreement should be treated similar to other zero cost capital items and, therefore, the net proceeds of the sale should be a reduction of rate base.

Because the Commission's X Order could be read to require a rate base adjustment inconsistent with that provided by sections 168(e)(3) and 46(f)(2) of the Code, the Company, on e, petitioned the Commission for rehearing in part with respect to the regulatory treatment accorded the net proceeds of the sale under the Agreement.

The Commission subsequently issued Y Order to the effect that the Company's motion for rehearing be conditionally granted on the issue of the proper ratemaking treatment of the Agreement. As stated therein, the effect of the Y Order, is to suspend the applicable portion of the Commission's decision in order to allow the Company the opportunity to obtain a definitive ruling by the Internal Revenue Service.

The ruling request has raised the following issues.

1. Is the last sentence of section 168(f)(8)(D) of the Code, added by Pub. L. No. 97-448, 1983-1 C.B. 451, 452 as in effect prior to amendment by Pub. L. No. 97-248, 1982-2 C.B. 461, applicable to the Agreement?
2. Does the Agreement entered into between the Company and the Lessor constitute an agreement with respect to qualified leased property under section 168(f) (8) if the Commission's temporary rate order becomes final?

For property placed in service after 1980, section 168(a) of the Code provides a deduction for recovery property. Under section 168(c) recovery property includes public utility property. Under section 168(c) (2)(E) 15-year public utility property means public utility property (other than section 1250 class property) with a present class life of more than 25 years. However, pursuant to section 168(e)(3) recovery property does not include public utility property if the taxpayer does not use a normalization method of accounting.

Section 46(f) of the Code provides that a credit allowed by section 38 is available for public utility property only if certain normalization methods are adopted. If the method provided in section 46(f)(2) is elected, no credit is allowed if the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by more than a ratable portion of the credit allowable by section 38. Further, no credit is allowed if the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38.

By reference to section 167(1)(3)(A) of the Code, section 168(g)(1) defines public utility property as trade or business property used for furnishing or the sale of certain specified services if the rates for such furnishing or sale have been established or approved by a State or its political subdivision, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or its political subdivision. See also, section 46(f)(5)

Section 102(a)(10)(A) of the Technical Corrections Act of 1982, 1983-1 C.B. 451, 453, states that section 168(f)(8)(D) as in effect before the amendment made by the Tax Equity and Fiscal Responsibility Act of 1982, includes the provision that public utility property should not be treated as

qualified leased property unless the requirements of rules similar to the rules of section 168(e)(3) and section 46(f) of the Code are met for such property. In its explanation of the Act's provisions, SEN. REPT. NO. 97-592, 1983-1 C.B. 475, 477, states that all amendments were meant to carry out the intent of Congress in enacting the original legislation. Further, the language added to section 168(f)(8)(D) applies to recovery property placed in service after 1980.

Thus, in this case, the language added to section 168(f) (8)(D) of the Code applies to the Property involved in the agreement. One of the requirements of section 46(f)(2) is that no portion of the credit allowable by section 38 can be used to reduce the base to which the taxpayer's rate of return for ratemaking purposes is applied. The Commission's temporary order reduces the Company's rate base by sales proceeds representing credits allowable by section 38. Consequently, if the Commission's rate order is made final, the Company will fail to satisfy the conditions of section 46(f) and Property is not qualified leased property.

Based upon the taxpayer's representations and the law and analysis discussed above, we conclude as follows:

1. The last sentence of section 168(f)(8)(D) of the Code, added by Pub. L. No. 97-448, as in effect prior to amendment by Pub. L. No. 97-248, is applicable to the Agreement.
2. The Agreement entered into between the Company and the Lessor does not constitute an agreement with respect to qualified leased property under section 168(f)(8) if the Commission's temporary rate order becomes final.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Section 6110(j)(3) of the Internal Revenue Code provides that this letter ruling may not be cited or relied on as precedent. This letter is directed only to the taxpayer who requested it. A copy is enclosed for section 6110 purposes.

Document Title: PLR 8537063 -- IRC Sec(s). 46
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