HANDY LAW LLC

January 15, 2014

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Luly E. Massaro, Clerk
RI Public Utilities Commission
89 Jefferson Blvd.
Warwick, RI 02888

Re: In re. Petition of Wind Energy Development, LLC and ACP Land, LLC Relating to Interconnection

Dear Ms. Massaro:

I have enclosed the original and nine copies of the above-referenced Petition.

Thank you for your assistance with these filings.

Sincerely,

Seth H. Handy

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

IN RE: PETITION OF WIND ENERGY)
DEVELOPMENT, LLC AND ACP LAND, LLC)
RELATING TO INTERCONNECTION)

PETITION FOR DISPUTE RESOLUTION

This is a petition brought by Wind Energy Development, LLC (WED) and ACP Land, LLC (ACP) (collectively Petitioners) against National Grid (NGrid) to resolve disputes related to interconnection pursuant to section 9.2 of the Narragansett Electric Company's Standards for Connecting Distributed Generation, RIPUC #2078" (the "Tariff). Petitioners assert that NGrid is: 1) charging a pass through interconnection tax from which these projects are exempt pursuant to federal law; 2) charging more than their cost of conducting interconnections; 3) charging more than their cost of conducting interconnection studies; and 4) not producing timely studies. Petitioners seek the Commission's investigation of interconnection rates and charges pursuant to R.I.G.L. §39-1-3(a) and violations of law and the Tariff. The parties have attempted good faith negotiation pursuant to section 9.1 of the Tariff but have not been able to resolve these disputes.

Summary of Claims

ACP has developed a 500kW solar project in Middletown, Rhode Island. WED has developed a 1.5MW wind turbine in North Kingstown, Rhode Island and currently plans to develop at least five more wind turbines, four in Coventry (WED Coventry I-IV) and one in North Smithfield (DV).

I. Interconnection Tax

Petitioners have paid approximately $23,000 in interconnection taxes to NGrid for the two installed projects and have been quoted over $270,000 in anticipated interconnection taxes for five

planned projects. The tax is assessed as a percentage of the total cost of interconnection and must be paid before NGrid will proceed with the interconnection work. The tax rate assessed to these projects has varied from 11.29% to 22.58% to 22.84% without notice or Commission approval. NGrid allegedly collects the interconnection tax in order to satisfy its obligation to the federal government for the payment of a "Contribution in Aid of Construction" (CIAC) tax - it is a "pass through" tax. However IRS Notices and private letter rulings make it clear that Qualifying Facilities like the projects addressed in this Petition, are exempt from the payment of this tax.

IRS Notice 88-129 (attached) states that when a Qualifying Facility transfers an intertie to a utility in connection with a sale of electricity by the Qualifying Facility to the utility, the utility does not realize income. Dual-use interties to a utility are treated as qualifying facility transfers (and, therefore, nontaxable) if, in light of all information available to the utility at the time of transfer, it is reasonably projected that during the first ten taxable years of the intertie, beginning with the year in which the transferred property is placed in service, no more than five percent of the projected total power flows over the intertie will flow to the Qualifying Facility. The IRS has modified that notice twice, in Notice 2001-82 (attached) and Notice 90-60 but the notices expand and do not contract the scope of the safe-harbor. The IRS has also issued private letter rulings reinforcing the application of this exemption to Qualifying Facilities like those developed or planned by Petitioners. PLR 1122005 (attached), 200134021 (attached), 200403084, 200320019. Petitioners demonstrated to NGrid their eligibility for this "safe-harbor" and requested refunds and elimination of the tax but NGrid has denied the requests.

NGrid takes the position that IRS Notice 88-129 only applies to transmission interconnections and not to interconnections to NGrid's distribution system. However, the Notice defines "intertie" as follows:

> PURPA and its implementing rules and regulations require that a utility interconnect with a Qualifying Facility for the purposes of allowing the sale of power produced by the Qualifying Facility. A Qualifying Facility must bear the cost of the purchase and installation of any equipment required for the interconnection. This equipment, referred to herein as an "intertie," may include new connecting and transmission facilities, or modifications, upgrades or relocations of a utility's existing transmission network.

IRS Notice 2001-82 expressly expanded the application of Notice 88-129, designed to safe-harbor interconnections for energy sales to the utility, to also safe-harbor interconnections allowing the QF to use the utility's transmission lines to wheel power to other customers. Moreover, IRS private letter rulings apply the safe-harbor in the context of interconnections to the distribution grid. PLR 1122005, 200134021. NGrid states that it cannot rely on existing IRS letter rulings so each individual project must obtain a private letter ruling allowing NGrid to claim the safe-harbor. Petitioners deem this position unreasonable given the clarity of the IRS Notices and the private letter rulings IRS has issued as administrative guidance (intended to avoid an onslaught of such repetitive requests for clarification).

2. Interconnection Cost

NGrid is not entitled to charge more than its actual cost of conducting interconnections and must, therefore, produce audits reflecting the actual cost and automatically refund any difference between the prepaid, estimated interconnection cost and the actual cost of interconnection. The Tariff requires an interconnecting customer to pay all System Modification costs (Sheets 9, 24, Sheet 39 ¶¶5.3 -5.4) at "reasonable" "actual costs." Moreover, Section 5.4 states:

> Should the Company combine the installation of System Modifications with additions to the Company's EPS to serve other customers or interconnecting customers, the Company shall not include the costs of such separate or incremental facilities in the amounts billed to the Interconnecting Customer for the System Modifications required pursuant to thisInterconnection Tariff.
>
> The Interconnecting Customer shall only pay for that portion of the interconnection costs resulting solely from the System Modifications required to allow for safe, reliable parallel

operation of the Facility with the Company EPS.The interconnection costs are first estimated in the feasibility study and then refined in the impact study.

The final estimated costs must be paid before the interconnection work will be done. In the absence of an audit upon completion, the customer has no way to determine whether the paid costs are "actual" or "reasonable" as required by the tariff or whether they include additions to the Company's Electric Power System to serve other customers.

NGrid's interconnection agreement requires that the customer request, within a specified time, a final accounting of interconnection ("system modification") costs before National Grid has an obligation to refund any estimated and prepaid costs that exceed the actual costs of the studies and System Modifications. Tarriff at Sheet 67 ¶7, Sheet 71 ¶7, Sheet 74 ¶5.2. This provision also only enables NGrid to recover costs exceeding its estimate upon the customer's request for an audit, leading both to NGrid's inclination toward conservative estimating and deterrent risk for customers requesting audits. This requirement of the agreement is inconsistent with the Tariff's requirement that NGrid charge no more than its reasonable, actual cost of system modifications necessary to achieve that specific project's interconnection. The audit and refund must be standard and automatic practice.

NGrid's interconnection cost estimate for Petitioner ACP's solar project anticipated a need to install three utility poles to interconnect the project but NGrid ultimately installed only one pole. ACP requested an audit on October 15, 2013, and has yet to receive the audit results.

NGrid first estimated an interconnection cost of $768,920 for WED's NK green project. When WED elected to proceed despite this (outrageously) high estimate, NGrid issued an impact study with a revised interconnection cost estimate of $169,767. WED prepaid that amount and did not request an audit within ninety days of completion of that project.[1] Nevertheless, NGrid is not

[1] Developers commonly fear retribution for questioning or challenging NGrid's interconnection practices, suspecting that their future applications (and business) will be negatively impacted by the request. This chill to market efficiency is symptomatic of utility administration of interconnection for renewable energy projects.

entitled to keep any difference between the estimated and actual interconnection costs for that project pursuant to the Tariff.

NGrid has takes the position that its form of interconnection agreement was approved with the Tariff and that its requirement of an audit request for the refund of any overcharge is authorized by the Commission unless and until the Commission revises the Tariff. However, section 20 of the Interconnection Agreement makes it clear that "[i]n the event of a conflict between this Agreement, the Interconnection Tariff, or the terms of any other tariff, Exhibit or Attachment incorporated by reference, the terms of the Interconnection Tariff, as the same may be amended from time to time, shall control." The language of the Tariff clearly conflicts with the audit request requirement in NGrid's form of Interconnection Agreement. Sound public policy does not support a result that enables NGrid to keep overcharges generated by its conservative cost estimating.

3. Interconnection studies

On June 29, 2011, Governor Chafee signed RIGL §39-26.3-4 into law, establishing that as of 30 days after enactment through the end of 2012, the following maximum fees for interconnection impact studies for non-residential projects: (i) between 250 kilowatts and 1 megawatt, $1000; and (ii) larger than one megawatt $2500 through the end of 2012. Beginning in 2013, RIGL §39-26.3-4 authorizes increased impact study fees as follows: (i) between 250 kilowatts and 1 megawatt, $5000; and (ii) larger than one megawatt $10,000. RIGL §39-26.3-4(c) provides an exception that NGrid can increase the amount charged for impact studies on non residential projects based on actual costs incurred for the study as assessed after project completion. RIGL §39-26.3-3(d) requires that NGrid issue its impact study report within ninety days of submission of an impact study application and payment of the study fee. Section 5.1 of the Tariff provides that "[t]he Interconnecting Customer shall be responsible for the <u>reasonably incurred costs</u> of the review by the Company and any

interconnection studies conducted. . ." (emphasis added)

In September 2011, NGrid entered an Impact Study Agreement with WED for its NK Green project requiring prepayment of $10,000 for an Impact Study and stating that they would notify NK of an increased assessment if the actual costs were higher than that. WED prepaid the $10,000 fee. Here again, customers are required to prepay the estimated costs of commercial interconnection studies before NGrid will complete them. NGrid has not sent Petitioners any audits documenting the actual cost of the studies and has not refunded any difference between the estimated cost and the actual cost of the studies.

Moreover, NGrid did not produce ACP's impact study or WED Coventry II's impact study within ninety days of the application and payment of the fee. ACP applied for an impact study and paid the fee on January 1, 2012, and did not receive the study until October 2, 2012. WED entered its impact study agreement and paid the study fee for its Coventry II project on or about September 23, 2013 and has yet to receive the completed study.

Conclusion

Petitioners ask the Commission to grant the following relief:

1. Order NGrid to refund the interconnection taxes Petitioners have paid and not to charge that tax when a qualifying facility transfers an intertie to NGrid in connection with a sale of electricity by the qualifying facility to the utility pursuant to IRS Notice 88-129 and the IRS letter rulings.

2. An order requiring National Grid to provide a final account of the actual, incurred cost of its interconnection feasibility and impact studies and its final System Modification costs and automatically (without the interconnecting customer's request) refund any difference between the estimated and final costs.

3. An order requiring National Grid to comply with the schedule requirements established at R.I.G.L. §39-26.3-3(d) or else forfeit its study fees.

WIND ENERGY DEVELOPMENT, LLC, & ACP LAND, LLC

By their attorneys,
HANDY LAW, LLC

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CERTIFICATE OF SERVICE

I hereby certify that on January 15, 2014, I delivered a true copy of the foregoing document to National Grid by electronic mail.

Seth H. Handy

IRS Letter Rulings and TAMs (1998-2012), UIL No. 0118.01-02 Contributions to the capital of a corporation; Contributions by shareholders; Nonshareholder contributions. UIL No. 0118.02-01 Contributions to the capital of a corporation; Contributions in aid of construction; Not included under subsection (a). UIL No. 0118.02-02 Contributions to the capital of a corporation; Contributions in aid of construction; Definition of contribution in aid of construction. IRS Letter Ruling 201122005 (Mar. 02, 2011), Internal Revenue Service, (Mar. 2, 2011)

Click to open document in a browser

LTR 201122005, March 02, 2011

Symbol: CC:PSI:B05-PLR-137108-10

Uniform Issue List Nos. 0118.01-02, 0118.02-01, 0118.02-02

[Code Sec. 118]

Contributions to the capital of a corporation: Contributions by shareholders: Nonshareholder contributions; Contributions to the capital of a corporation; Contributions in aid of construction; Not included under subsection (a); Contributions to the capital of a corporation; Contributions in aid of construction; Definition of contribution in aid of construction.

This letter responds to your letter dated September 9, 2010, requesting a letter ruling concerning whether the transfer of an intertie from Generator to Taxpayer is a nonshareholder contribution to capital excludable from Taxpayer's income under § 118(a) of the Internal Revenue Code.

Taxpayer is a State 2 Corporation engaged in the business of generating, transmitting and distributing electrical energy to wholesale and retail customers predominantly in State 2. Taxpayer is a wholly-owned subsidiary of Corp 1, a State 2 corporation. Taxpayer and Corp 1 file a consolidated federal income tax return on a calendar year basis using the accrual method of accounting.

Generator, a State 1 limited liability company, will own, operate and maintain Facility located at Site. Generator submitted applications to Taxpayer for interconnection of Facility with the transmission and distribution system belonging to Taxpayer and Corp 2 (collectively the "Grid") at Substation 1.

On Date 1, Taxpayer filed Agreement 1, Agreement 2 and Agreement 3 (collectively, the "Agreements") between Taxpayer and Generator. Under the Agreements, Generator requests that Taxpayer interconnect Facility to Taxpayer's distribution system via a dedicated position at Substation 2. Taxpayer will engineer, design, procure, construct, install, own, operate, and maintain the facilities required to interconnect Facility to Taxpayer's distribution system (the "Interconnection Facilities"). Taxpayer also will engineer, design, procure construct, install, own, operate and maintain certain upgrades to its distribution system ("Distribution Upgrades"). Generator is responsible for the costs of those assets, which are estimated to be $c.

Agreement 3 specifies the terms and conditions under which Taxpayer will engineer, design, procure, construct, install, own, operate and maintain the ***** Facilities, and for Generator to pay for the ***** Facilities. The ***** Facilities are the facilities necessary to connect Facility's switchyard to the Interconnection Facilities at Substation 2 other than the Interconnection Facilities and the Distribution Upgrades. The cost of the ***** Facilities is estimated to be $d.

The Interconnection Facilities, the Distribution Upgrades, and the ***** Facilities, together are referred to as the "intertie."

Agreement 2 sets forth Taxpayer's agreement to provide distribution service for e Megawatts produced by Facility from Facility's interconnection at Substation 2 to the Grid at Substation 1. Agreement 2 terminates on the earliest of 1) f years from the commencement of distribution service under Agreement 2, or 2) the

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termination of Agreement 1. Agreement 1 has a term of f years and is automatically renewed for each successive g-year period.

Taxpayer will be the owner and sole operator of the intertie and the intertie will become a permanent part of Taxpayer's transmission and distribution system. Generator has entered into contracts and expects to enter into additional contracts with end users and power marketers to sell power from Facility. Taxpayer represents that the intertie will not be included in Taxpayer's rate base, and that Taxpayer will not take any depreciation deductions with respect to the intertie.

Generator represents: (1) Facility is a stand-alone generator as contemplated under Notice 2001-82; (2) The intertie will be used in connection with the transmission and distribution of electricity for sale to third parties; (3) Title to the electricity will pass to purchasers at the busbar on Facility's end of the intertie; (4) Generator will capitalize the contribution as an intangible asset and recovered using the straight-line method of accounting over a useful life of 20 years; and (5) Any portion of the intertie that is a dual use intertie within the meaning of Notice 88-129, 1988-2 C.B. 541, is reasonably expected to carry no more than a de minimis amount of electricity to Facility or to Generator or a related person (defined as no more than 5 percent of the projected power flows in both directions over the intertie during Generator's first 10 years after the intertie is placed in service).

Taxpayer requests a ruling that the contribution of cash for construction of the intertie by Generator to Taxpayer will not be considered a contribution in aid of construction under § 118(b) (CIAC), and will be excludable from Taxpayer's income as a non-shareholder contribution to capital under § 118(a).

Section 61(a) and § 1.61-1 of the Income Tax Regulations provide that gross income means all income from whatever source derived, unless excluded by law. Section 118(a) provides that in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Section 118(b), as amended by § 824(a) of the Tax Reform Act of 1986 (the 1986 Act) and § 1613(a) of the Small Business Job Protection Act of 1996, provides that for purposes of subsection (a), except as provided in subsection (c), the term "contribution to the capital of taxpayer" does not include any CIAC or any other contribution as a customer or potential customer.

Section 1.118-1 of the Income Tax Regulations provides, in part, that § 118 also applies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of enabling the corporation to expand its operating facilities. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid to induce the taxpayer to limit production.

The legislative history to § 118 indicates that the exclusion from gross income for nonshareholder contributions to capital of a corporation was intended to apply to those contributions that are neither gifts, because the contributor expects to derive indirect benefits, nor payments for future services, because the anticipated future benefits are too intangible. The legislative history also indicates that the provision was intended to codify the existing law that had developed through administrative and court decisions on the subject. H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 17 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 18-19 (1954).

Notice 88-129, 1988-2 C.B. 541, as modified and amended by Notice 90-60, 1990-2 C.B. 345, and Notice 2001-82, 2001-2 C.B. 619, provides specific guidance with respect to the treatment of transfers of property to regulated public utilities by qualifying small power producers and qualifying cogenerators (collectively, Qualifying Facilities), as defined in section 3 of the Federal Power Act, as amended by section 201 of PURPA.

The amendment of § 118(b) by the 1986 Act was intended to require utilities to include in income the value of any CIACs made to encourage the provision of services by a utility to a customer. See H.R. Rep. No. 841, 99th Cong., 2d Sess. 324 (1986). In a CIAC transaction, the purpose of the contribution of property to the utility is to facilitate the sale of power by the utility to a customer. In contrast, the purpose of the contribution by a Qualifying Facility to a utility is to permit the sale of power by the Qualifying Facility to the utility. Accordingly, the fact that the 1986 amendments to § 118(b) render CIAC transactions taxable to the utility does not require a similar conclusion with respect to transfers from Qualifying Facilities to utilities.

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Notice 88-129 provides that with respect to transfers made by a Qualifying Facility to a utility exclusively in connection with the sale of electricity by the Qualifying Facility to the utility, a utility will not realize income upon transfer of interconnection equipment (intertie) by a Qualifying Facility. The possibility that an intertie may be used to transmit power to a utility that will in turn transmit the power across its transmission network for sale by the Qualifying Facility to another utility (wheeling) will not cause the contribution to be treated as a CIAC.

Further, the notice provides that a transfer from a Qualifying Facility to a utility will not be treated as a Qualifying Facility transfer (QF transfer) under this notice to the extent the intertie is included in the utility's rate base. Moreover, a transfer of an intertie to a utility will not be treated as a QF transfer under this notice if the term of the power purchase contract is less than ten years.

The notice also provides that a utility that constructs an intertie in exchange for a cash payment from a Qualifying Facility pursuant to a PURPA contract will be deemed to construct the property under contract and will recognize income from the construction in the same manner as any other taxpayer constructing similar property under contract. Subsequent to the construction of the property, the Qualifying Facility will be deemed to transfer the property to the utility in a QF transfer that will be treated in exactly the same manner as an in-kind QF transfer.

Notice 2001-82 amplifies and modifies Notice 88-129. Notice 2001-82 extends the safe harbor provisions of Notice 88-129 to include transfers of interties from nonQualifying Facilities, and transfers of interties used exclusively or in part to transmit power over the utility's transmission grid for sale to consumers or intermediaries (wheeling). The notice requires that ownership of the electricity wheeled passes to the purchaser prior to its transmission on the utility's transmission grid. This ownership requirement is deemed satisfied if title passes at the busbar on the generator's end of the intertie. Further, Notice 2001-82 provides that a long-term interconnection agreement in lieu of a long-term power purchase contract may be used to satisfy the safe harbor provisions of Notice 88-129 in wheeling transactions. Finally, Notice 2001-82 requires that the generator must capitalize the cost of the property transferred as an intangible asset and recover such cost using the straight-line method over a useful life of 20 years.

In the instant case, the transfer of the intertie is subject to the guidance set forth in Notice 88-129, Notice 90-60, and Notice 2001-82 for the following reasons: (1) Facility is a stand-alone generator as contemplated under Notice 2001-82; (2) Generator and Taxpayer entered into a long-term interconnection agreement; (3) the intertie will be used in connection with the transmission of electricity for sale to third parties (wheeling); (4) the cost of the intertie paid by Generator will not be included in Taxpayer's rate base; (5) Taxpayer will not take any depreciation deductions with respect to the intertie; (6) based on all available information, the portion of the intertie that is a dual use intertie is reasonably expected to carry no more than 5 percent of the projected power flows in both directions over the intertie during the first 10 taxable years beginning in the year the intertie is placed in service; (7) ownership of the electricity produced by Facility that is wheeled will pass to the purchaser prior to its transmission on Taxpayer's transmission grid; and (8) the cost of the intertie will be capitalized by Generator as an intangible asset and recovered using the straight-line method over a useful life of 20 years. Thus, we conclude that the deemed contribution of the intertie by Generator to Taxpayer meets the safe harbor requirements of Notice 88-129, as amended and modified by Notice 90-60 and Notice 2001-82.

Next, we must decide whether the contribution qualifies as a contribution to capital under § 118(a).

The legislative history of § 118 provides, in part, as follows:

This [§ 118] in effect places in the Code the court decisions on the subject. It deals with cases where a contribution is made to a corporation by a governmental unit, chamber of commerce, or other association of individuals having no proprietary interest in the corporation. In many such cases because the contributor expects to derive indirect benefits, the contribution cannot be called a gift; yet the anticipated future benefits may also be so intangible as to not warrant treating the treating the contribution as a payment for future services.

S. Rep. No. 1622, 83d Cong., 2d Sess. 18-19 (1954).

In Detroit Edison Co. v. Commissioner, 319 U.S. 98 (1943) [43-1 USTC ¶9418], the Court held that payments by prospective customers to an electric utility company to cover the cost of extending the utility's

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facilities to their homes, were part of the price of service rather than contributions to capital. The case concerned customers' payments to a utility company for the estimated cost of constructing service facilities (primary power lines) that the utility company otherwise was not obligated to provide. The customers intended no contribution to the company's capital.

Later, in Brown Shoe Co. v. Commissioner, 339 U.S. 583 (1950) [50-1 USTC ¶5958], 1950-1 C.B. 38, the Court held that money and property contributions by community groups to induce a shoe company to locate or expand its factory operations in the contributing communities were nonshareholder contributions to capital. The Court reasoned that when the motivation of the contributors is to benefit the community at large and the contributors do not anticipate any direct benefit from their contributions, the contributions are nonshareholder contributions to capital. Id. at 41.

Finally, in United States v. Chicago, Burlington & Quincy Railroad Co., 412 U.S. 401, 413 (1973) [73-1 USTC ¶9478], the Court, in determining whether a taxpayer was entitled to depreciate the cost of certain facilities that had been funded by the federal government, held that the governmental subsidies were not contributions to the taxpayer's capital. The court recognized that the holding in Detroit Edison Co. had been qualified by its decision in Brown Shoe Co. The Court in Chicago, Burlington & Quincy Railroad Co. found that the distinguishing characteristic between those two cases was the differing purpose motivating the respective transfers. In Brown Shoe Co., the only expectation of the contributors was that such contributions might prove advantageous to the community at large. Thus, in Brown Shoe Co., since the transfers were made with the purpose, not of receiving direct services or recompense, but only of obtaining advantage for the general community, the result was a contribution to capital.

The Court in Chicago, Burlington & Quincy Railroad Co. also stated that there were other characteristics of a nonshareholder contribution to capital implicit in Detroit Edison Co. and Brown Shoe Co. From these two cases, the Court distilled some of the characteristics of a nonshareholder contribution to capital under both the 1939 and 1954 Codes. First, the payment must become a permanent part of the transferee's working capital structure. Second, it may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee. Third, it must be bargained for. Fourth, the asset transferred foreseeably must benefit the transferee in an amount commensurate with its value. Fifth, the asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect.

The transfer of the intertie by Generator to Taxpayer possesses the characteristics of a nonshareholder contribution to capital as described in Chicago, Burlington & Quincy Railroad Co. First, the intertie will become a permanent part of Taxpayer's working capital structure. Second, the transfer is not compensation for services provided by for Generator by Taxpayer. Third, the transfer is a bargained-for exchange. Fourth, the transfer will foreseeably result in a benefit to Taxpayer commensurate with its value because the intertie will become part of Taxpayer's transmission system. Fifth, the intertie will be used by Taxpayer in its trade or business for producing gross income. Therefore, Taxpayer's receipt from Generator of the intertie will be a contribution to capital under § 118(a).

Accordingly, based solely on the foregoing analysis and the representations made by Taxpayer, we rule that the transfer of the intertie by Generator to Taxpayer will not be a CIAC under § 118(b) and will be excludable from the gross income of Taxpayer as a nonshareholder contribution to capital under § 118(a).

Except as specifically set forth above, no opinion is expressed or implied concerning the federal income tax consequences of the above described facts under any other provision of the Code or regulations.

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

This ruling is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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

Sincerely, Nicole R. Cimino, Senior Technician Reviewer, Branch 5 (Passthroughs & Special Industries).

cc: *****

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Part III - Administrative, Procedural, and Miscellaneous

Expansion of Safe Harbor Provisions Under Notice 88-129

Notice 2001-82

PURPOSE

This notice amplifies and modifies Notice 88-129, 1988-2 C.B. 541, as modified and amplified by Notice 90-60, 1990-2 C.B. 345. Notice 88-129 provides that a regulated public utility (utility) will not realize income upon transfers of interties from qualifying small power producers and qualifying cogenerators (collectively, Qualifying Facilities), as defined in section 3 of the Federal Power Act, as amended by section 201 of the Public Utilities Regulatory Policies Act of 1978 (PURPA). This notice extends the safe harbor provisions of Notice 88-129 to include transfers of interties from non-Qualifying Facilities. The safe harbor also is extended to transactions in which there is not a long-term power purchase contract between the utility and the power producer but rather the intertie is transferred pursuant to a long-term interconnection agreement and in which the intertie is used exclusively to transmit power across the utility's transmission grid for sale to consumers or intermediaries.

BACKGROUND

At the time Notice 88-129 was issued, most generators that were not owned by regulated public utilities (stand-alone generators) were Qualifying Facilities for regulatory purposes. As a stand-alone generator, the Qualifying Facility had to be connected to a utility's transmission lines in order to move its power to market. PURPA required that a utility interconnect with a Qualifying Facility for the purpose of allowing the sale of power produced by the Qualifying Facility. A Qualifying Facility generally sold its electricity under a long-term power purchase contract to the local utility with whom it was interconnecting at the utility's avoided cost. A Qualifying Facility also arranged in certain cases for the interconnected utility to transmit electricity across its transmission grid for sale to another utility (wheeling) at that utility's avoided cost.

Deregulation of the electric power industry has significantly changed the operation of the industry. Today, few new stand-alone generators are Qualifying Facilities. The Federal Energy Regulatory Commission (FERC) encouraged the construction of non-Qualifying Facilities starting in the late 1980's by issuing a number of orders to individual projects (known in the industry as independent power producers) approving sales of power at market rates. In addition, the Energy Policy Act of 1992 created a new class of stand-alone generators, called exempt wholesale generators, that are permitted to sell their power at market rates with FERC approval, and are exempted from certain utility regulation. Unlike PURPA, the Energy Policy Act has no requirement that utilities buy electricity from stand-alone generators.

In 1996, FERC issued Order No. 888 in an effort to ensure that every wholesale supplier of electricity, including, for example, power marketers and stand-alone generators, has open access to the national transmission grid. The order requires regulated utilities to allow stand-alone generators to interconnect to the grid and to file nondiscriminatory tariffs under which any wholesale supplier can pay to have its electricity wheeled. Stand-alone generators (including Qualifying Facilities) have additional outlets for their power today that they did not have in 1988, including sales of power at auction on regional power exchanges or spot markets and under short and medium-term contracts to specific customers or to power marketers that trade electricity. Regulated utilities have many more sources of supply for electricity than in 1988. As a result of these changes, very few utilities enter into long-term power purchase contracts with stand-alone generators. Electricity produced by stand-alone generators is more likely today than in 1988 to be wheeled across the transmission grid of the interconnected utility for sale to consumers or intermediaries rather than to be sold directly to the interconnected utility.

The new stand-alone generators still need to be interconnected to the transmission grid in order for a customer to take the power. Therefore, the stand-alone generator enters into a long-term interconnection agreement with the local utility. The term of a long-term interconnection agreement may be tied to the period that the stand-alone generator remains in commercial operation. This agreement may permit assignment of the agreement by the utility to accommodate future consolidation of local grids into regional transmission systems that will cover broad regions of the country.

MODIFICATIONS TO NOTICE 88-129 AND NOTICE 90-60

In light of the above-mentioned changes in the electric power industry, the safe harbor provisions of Notice 88-129 are modified as follows:

1. The safe harbor provisions are extended to include transfers of interties from non-Qualifying Facilities. Accordingly, the term "QF transfer" appearing in Notice 88-129 will be construed as including "qualified transfers" of interties from non-Qualifying Facilities that meet the other requirements of the safe harbor provisions. Similarly, the term "Qualifying Facility" for purposes of Notice 88-129 will be construed as including "stand-alone generators" that are not Qualifying Facilities.

2. The safe harbor provisions also are extended to include transfers of interties used exclusively or in part to transmit power over the utility's transmission grid for sale to consumers or intermediaries, including affiliated intermediaries (wheeling). This safe harbor only applies to transactions in which the intertie is transferred pursuant to a long-term interconnection agreement and in which ownership of the electricity wheeled passes to the purchaser prior to its transmission on the utility's transmission grid. The ownership requirement of the preceding sentence is deemed satisfied if title to electricity wheeled passes to the purchaser at the busbar on the generator's end of the intertie. The terms "power purchase contract" and "power supply contract" appearing in Notice 88-129 will be construed as including interconnection agreements in transactions in which the intertie is used for wheeling. Accordingly, a long-term interconnection agreement in lieu of a long-term power purchase contract or power supply contract may be used to satisfy the safe harbor provisions of Notice 88-129 in such transactions.

The term “dual-use intertie” appearing in Notice 88-129 will be construed as including an intertie which may be used to transmit power from a third party for sale to the Qualifying Facility.

3. Section 6, sentence 4, of Notice 88-129, states, “The cost of property transferred in a QF transfer must be capitalized by the Qualifying Facility as an intangible asset and recovered as appropriate.” This sentence is modified to read as follows: “The cost of property transferred in a QF transfer must be capitalized by the Qualified Facility as an intangible asset and recovered using the straight-line method over a useful life of 20 years.”

EFFECT ON OTHER DOCUMENTS

Notice 88-129, as amplified and modified by Notice 90-60, is further amplified and modified.

EFFECTIVE DATE

This notice applies to transfers of property to regulated public utilities pursuant to interconnection agreements completed after December 24, 2001, the date this notice is published in the Bulletin. For transfers of interties occurring on or before December 24, 2001 and meeting the requirements of this notice, taxpayers may request application of this notice through a request for a private letter ruling (including, in appropriate circumstances, where the taxpayer’s return for the year of transfer has already been filed).

DRAFTING INFORMATION

The principal author of this notice is Gregory N. Doran of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Mr. Doran at (202) 622-3040 (not a toll-free call).

IRS Letter Rulings and TAMs (1998-2012), UIL No. 0118.01-02 Contributions to the capital of a corporation; Contributions by shareholders; Nonshareholder contributions. UIL No. 0118.02-01 Contributions to the capital of a corporation; Contributions in aid of construction; Not included under subsection (a). UIL No. 0118.02-02 Contributions to the capital of a corporation; Contributions in aid of construction; Definition of contribution in aid of construction. IRS Letter Ruling 201122005 (Mar. 02, 2011), Internal Revenue Service, (Mar. 2, 2011)

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LTR 201122005, March 02, 2011

Symbol: CC:PSI:B05-PLR-137108-10

Uniform Issue List Nos. 0118.01-02, 0118.02-01, 0118.02-02

[Code Sec. 118]

Contributions to the capital of a corporation; Contributions by shareholders; Nonshareholder contributions; Contributions to the capital of a corporation; Contributions in aid of construction; Not included under subsection (a); Contributions to the capital of a corporation; Contributions in aid of construction; Definition of contribution in aid of construction.

This letter responds to your letter dated September 9, 2010, requesting a letter ruling concerning whether the transfer of an intertie from Generator to Taxpayer is a nonshareholder contribution to capital excludable from Taxpayer's income under § 118(a) of the Internal Revenue Code.

Taxpayer is a State 2 Corporation engaged in the business of generating, transmitting and distributing electrical energy to wholesale and retail customers predominantly in State 2. Taxpayer is a wholly-owned subsidiary of Corp 1, a State 2 corporation. Taxpayer and Corp 1 file a consolidated federal income tax return on a calendar year basis using the accrual method of accounting.

Generator, a State 1 limited liability company, will own, operate and maintain Facility located at Site. Generator submitted applications to Taxpayer for interconnection of Facility with the transmission and distribution system belonging to Taxpayer and Corp 2 (collectively the "Grid") at Substation 1.

On Date 1, Taxpayer filed Agreement 1, Agreement 2 and Agreement 3 (collectively, the "Agreements") between Taxpayer and Generator. Under the Agreements, Generator requests that Taxpayer interconnect Facility to Taxpayer's distribution system via a dedicated position at Substation 2. Taxpayer will engineer, design, procure, construct, install, own, operate, and maintain the facilities required to interconnect Facility to Taxpayer's distribution system (the "Interconnection Facilities"). Taxpayer also will engineer, design, procure construct, install, own, operate and maintain certain upgrades to its distribution system ("Distribution Upgrades"). Generator is responsible for the costs of those assets, which are estimated to be $c.

Agreement 3 specifies the terms and conditions under which Taxpayer will engineer, design, procure, construct, install, own, operate and maintain the ***** Facilities, and for Generator to pay for the ***** Facilities. The ***** Facilities are the facilities necessary to connect Facility's switchyard to the Interconnection Facilities at Substation 2 other than the Interconnection Facilities and the Distribution Upgrades. The cost of the ***** Facilities is estimated to be $d.

The Interconnection Facilities, the Distribution Upgrades, and the ***** Facilities, together are referred to as the "intertie."

Agreement 2 sets forth Taxpayer's agreement to provide distribution service for e Megawatts produced by Facility from Facility's interconnection at Substation 2 to the Grid at Substation 1. Agreement 2 terminates on the earliest of 1) f years from the commencement of distribution service under Agreement 2, or 2) the

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termination of Agreement 1. Agreement 1 has a term of f years and is automatically renewed for each successive g-year period.

Taxpayer will be the owner and sole operator of the intertie and the intertie will become a permanent part of Taxpayer's transmission and distribution system. Generator has entered into contracts and expects to enter into additional contracts with end users and power marketers to sell power from Facility. Taxpayer represents that the intertie will not be included in Taxpayer's rate base, and that Taxpayer will not take any depreciation deductions with respect to the intertie.

Generator represents: (1) Facility is a stand-alone generator as contemplated under Notice 2001-82; (2) The intertie will be used in connection with the transmission and distribution of electricity for sale to third parties; (3) Title to the electricity will pass to purchasers at the busbar on Facility's end of the intertie; (4) Generator will capitalize the contribution as an intangible asset and recovered using the straight-line method of accounting over a useful life of 20 years; and (5) Any portion of the intertie that is a dual use intertie within the meaning of Notice 88-129, 1988-2 C.B. 541, is reasonably expected to carry no more than a de minimis amount of electricity to Facility or to Generator or a related person (defined as no more than 5 percent of the projected power flows in both directions over the intertie during Generator's first 10 years after the intertie is placed in service).

Taxpayer requests a ruling that the contribution of cash for construction of the intertie by Generator to Taxpayer will not be considered a contribution in aid of construction under § 118(b) (CIAC), and will be excludable from Taxpayer's income as a non-shareholder contribution to capital under § 118(a).

Section 61(a) and § 1.61-1 of the Income Tax Regulations provide that gross income means all income from whatever source derived, unless excluded by law. Section 118(a) provides that in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Section 118(b), as amended by § 824(a) of the Tax Reform Act of 1986 (the 1986 Act) and § 1613(a) of the Small Business Job Protection Act of 1996, provides that for purposes of subsection (a), except as provided in subsection (c), the term "contribution to the capital of taxpayer" does not include any CIAC or any other contribution as a customer or potential customer.

Section 1.118-1 of the Income Tax Regulations provides, in part, that § 118 also applies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of enabling the corporation to expand its operating facilities. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid to induce the taxpayer to limit production.

The legislative history to § 118 indicates that the exclusion from gross income for nonshareholder contributions to capital of a corporation was intended to apply to those contributions that are neither gifts, because the contributor expects to derive indirect benefits, nor payments for future services, because the anticipated future benefits are too intangible. The legislative history also indicates that the provision was intended to codify the existing law that had developed through administrative and court decisions on the subject. H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 17 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 18-19 (1954).

Notice 88-129, 1988-2 C.B. 541, as modified and amended by Notice 90-60, 1990-2 C.B. 345, and Notice 2001-82, 2001-2 C.B. 619, provides specific guidance with respect to the treatment of transfers of property to regulated public utilities by qualifying small power producers and qualifying cogenerators (collectively, Qualifying Facilities), as defined in section 3 of the Federal Power Act, as amended by section 201 of PURPA.

The amendment of § 118(b) by the 1986 Act was intended to require utilities to include in income the value of any CIACs made to encourage the provision of services by a utility to a customer. See H.R. Rep. No. 841, 99th Cong., 2d Sess. 324 (1986). In a CIAC transaction, the purpose of the contribution of property to the utility is to facilitate the sale of power by the utility to a customer. In contrast, the purpose of the contribution by a Qualifying Facility to a utility is to permit the sale of power by the Qualifying Facility to the utility. Accordingly, the fact that the 1986 amendments to § 118(b) render CIAC transactions taxable to the utility does not require a similar conclusion with respect to transfers from Qualifying Facilities to utilities.

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Notice 88-129 provides that with respect to transfers made by a Qualifying Facility to a utility exclusively in connection with the sale of electricity by the Qualifying Facility to the utility, a utility will not realize income upon transfer of interconnection equipment (intertie) by a Qualifying Facility. The possibility that an intertie may be used to transmit power to a utility that will in turn transmit the power across its transmission network for sale by the Qualifying Facility to another utility (wheeling) will not cause the contribution to be treated as a CIAC.

Further, the notice provides that a transfer from a Qualifying Facility to a utility will not be treated as a Qualifying Facility transfer (QF transfer) under this notice to the extent the intertie is included in the utility's rate base. Moreover, a transfer of an intertie to a utility will not be treated as a QF transfer under this notice if the term of the power purchase contract is less than ten years.

The notice also provides that a utility that constructs an intertie in exchange for a cash payment from a Qualifying Facility pursuant to a PURPA contract will be deemed to construct the property under contract and will recognize income from the construction in the same manner as any other taxpayer constructing similar property under contract. Subsequent to the construction of the property, the Qualifying Facility will be deemed to transfer the property to the utility in a QF transfer that will be treated in exactly the same manner as an in-kind QF transfer.

Notice 2001-82 amplifies and modifies Notice 88-129. Notice 2001-82 extends the safe harbor provisions of Notice 88-129 to include transfers of interties from nonQualifying Facilities, and transfers of interties used exclusively or in part to transmit power over the utility's transmission grid for sale to consumers or intermediaries (wheeling). The notice requires that ownership of the electricity wheeled passes to the purchaser prior to its transmission on the utility's transmission grid. This ownership requirement is deemed satisfied if title passes at the busbar on the generator's end of the intertie. Further, Notice 2001-82 provides that a long-term interconnection agreement in lieu of a long-term power purchase contract may be used to satisfy the safe harbor provisions of Notice 88-129 in wheeling transactions. Finally, Notice 2001-82 requires that the generator must capitalize the cost of the property transferred as an intangible asset and recover such cost using the straight-line method over a useful life of 20 years.

In the instant case, the transfer of the intertie is subject to the guidance set forth in Notice 88-129, Notice 90-60, and Notice 2001-82 for the following reasons: (1) Facility is a stand-alone generator as contemplated under Notice 2001-82; (2) Generator and Taxpayer entered into a long-term interconnection agreement; (3) the intertie will be used in connection with the transmission of electricity for sale to third parties (wheeling); (4) the cost of the intertie paid by Generator will not be included in Taxpayer's rate base; (5) Taxpayer will not take any depreciation deductions with respect to the intertie; (6) based on all available information, the portion of the intertie that is a dual use intertie is reasonably expected to carry no more than 5 percent of the projected power flows in both directions over the intertie during the first 10 taxable years beginning in the year the intertie is placed in service; (7) ownership of the electricity produced by Facility that is wheeled will pass to the purchaser prior to its transmission on Taxpayer's transmission grid; and (8) the cost of the intertie will be capitalized by Generator as an intangible asset and recovered using the straight-line method over a useful life of 20 years. Thus, we conclude that the deemed contribution of the intertie by Generator to Taxpayer meets the safe harbor requirements of Notice 88-129, as amended and modified by Notice 90-60 and Notice 2001-82.

Next, we must decide whether the contribution qualifies as a contribution to capital under § 118(a).

The legislative history of § 118 provides, in part, as follows:

This [§ 118] in effect places in the Code the court decisions on the subject. It deals with cases where a contribution is made to a corporation by a governmental unit, chamber of commerce, or other association of individuals having no proprietary interest in the corporation. In many such cases because the contributor expects to derive indirect benefits, the contribution cannot be called a gift; yet the anticipated future benefits may also be so intangible as to not warrant treating the treating the contribution as a payment for future services.

S. Rep. No. 1622, 83d Cong., 2d Sess. 18-19 (1954).

In Detroit Edison Co. v. Commissioner, 319 U.S. 98 (1943) [43-1 USTC ¶9418], the Court held that payments by prospective customers to an electric utility company to cover the cost of extending the utility's

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facilities to their homes, were part of the price of service rather than contributions to capital. The case concerned customers' payments to a utility company for the estimated cost of constructing service facilities (primary power lines) that the utility company otherwise was not obligated to provide. The customers intended no contribution to the company's capital.

Later, in Brown Shoe Co. v. Commissioner, 339 U.S. 583 (1950) [50-1 USTC ¶5958], 1950-1 C.B. 38, the Court held that money and property contributions by community groups to induce a shoe company to locate or expand its factory operations in the contributing communities were nonshareholder contributions to capital. The Court reasoned that when the motivation of the contributors is to benefit the community at large and the contributors do not anticipate any direct benefit from their contributions, the contributions are nonshareholder contributions to capital. Id. at 41.

Finally, in United States v. Chicago, Burlington & Quincy Railroad Co., 412 U.S. 401, 413 (1973) [73-1 USTC ¶9478], the Court, in determining whether a taxpayer was entitled to depreciate the cost of certain facilities that had been funded by the federal government, held that the governmental subsidies were not contributions to the taxpayer's capital. The court recognized that the holding in Detroit Edison Co. had been qualified by its decision in Brown Shoe Co. The Court in Chicago, Burlington & Quincy Railroad Co. found that the distinguishing characteristic between those two cases was the differing purpose motivating the respective transfers. In Brown Shoe Co., the only expectation of the contributors was that such contributions might prove advantageous to the community at large. Thus, in Brown Shoe Co., since the transfers were made with the purpose, not of receiving direct services or recompense, but only of obtaining advantage for the general community, the result was a contribution to capital.

The Court in Chicago, Burlington & Quincy Railroad Co. also stated that there were other characteristics of a nonshareholder contribution to capital implicit in Detroit Edison Co. and Brown Shoe Co. From these two cases, the Court distilled some of the characteristics of a nonshareholder contribution to capital under both the 1939 and 1954 Codes. First, the payment must become a permanent part of the transferee's working capital structure. Second, it may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee. Third, it must be bargained for. Fourth, the asset transferred foreseeably must benefit the transferee in an amount commensurate with its value. Fifth, the asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect.

The transfer of the intertie by Generator to Taxpayer possesses the characteristics of a nonshareholder contribution to capital as described in Chicago, Burlington & Quincy Railroad Co. First, the intertie will become a permanent part of Taxpayer's working capital structure. Second, the transfer is not compensation for services provided by for Generator by Taxpayer. Third, the transfer is a bargained-for exchange. Fourth, the transfer will foreseeably result in a benefit to Taxpayer commensurate with its value because the intertie will become part of Taxpayer's transmission system. Fifth, the intertie will be used by Taxpayer in its trade or business for producing gross income. Therefore, Taxpayer's receipt from Generator of the intertie will be a contribution to capital under § 118(a).

Accordingly, based solely on the foregoing analysis and the representations made by Taxpayer, we rule that the transfer of the intertie by Generator to Taxpayer will not be a CIAC under § 118(b) and will be excludable from the gross income of Taxpayer as a nonshareholder contribution to capital under § 118(a).

Except as specifically set forth above, no opinion is expressed or implied concerning the federal income tax consequences of the above described facts under any other provision of the Code or regulations.

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

This ruling is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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

Sincerely, Nicole R. Cimino, Senior Technician Reviewer, Branch 5 (Passthroughs & Special Industries).

cc: *****

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Internal Revenue Service

Number: **200134021**
Release Date: 8/24/2001
Index Number: 118.00–00
118.02–00

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:5–PLR-105349–01
Date:
May 30, 2001

,

In re:

LEGEND

Taxpayer =

Transferor =
State =
City =
Plant =
a =
b =
c =
d =
Date 1 =
Date 2 =

Dear :

This letter responds to your letter dated December 18, 2000, and subsequent correspondence submitted on behalf of Taxpayer, requesting a letter ruling concerning the treatment under §118 of the Internal Revenue Code of the transfer of certain interconnection equipment by Transferor to Taxpayer.

Taxpayer represents that the facts are as follows.

FACTS

Taxpayer is a regulated public utility located in State that is primarily engaged in the generation, transmission, and distribution of electricity to retail and wholesale customers.

Transferor is the owner and operator of a cogeneration facility (Facility) that is an integral part of Transferor's Plant located in City. The Facility is a qualified facility, as defined in section 3 of the Federal Power Act, as amended by section 201 of the Public Utilities Regulatory Policies Act of 1978 (PURPA). On Date 1, the Federal Energy Regulatory Commission (FERC) assigned to the Facility the qualifying facility identification number of a.

The Facility began operation in Date 2. The Facility and the Plant are operated as an integrated facility that is isolated from Taxpayer's transmission grid. The Facility has approximately b megawatts of excess, as available electric power that can be either sold at avoided cost to Taxpayer or delivered and sold to wholesale markets as permitted under PURPA and the Energy Policy Act of 1992.

Taxpayer will construct certain interconnection facilities (Interconnection Facilities) at Transferor's sole expense. After the construction is complete, Transferor will transfer ownership of the Interconnection Facilities to Taxpayer. Thereafter, the Interconnection Facilities will be owned, operated, and maintained by Taxpayer at its expense. The Interconnection Facilities will not be included in Taxpayer's rate base, and Taxpayer will not earn a return on the cost of constructing the Interconnection Facilities. For regulatory accounting purposes, Taxpayer will not include the cost of the Interconnection Facilities in its regulatory expenses nor will it include the reimbursement from Transferor of these costs in its regulatory income.

Taxpayer and Transferor have entered into a long-term power purchase agreement (PPA) for the purchase of electricity from the Facility. The PPA has an initial term of 10 years.

Further, Taxpayer and Transferor have entered into an Interconnection and Operating Agreement (IOA) pursuant to Taxpayer's Open Access Transmission Tariff filed with FERC. The purpose of the IOA is to allow Transferor to deliver energy to FERC approved power marketers for sale to other entities. Transferor will sell approximately c percent or more (but in no event less than d percent) of the electric power from the Facility on an annual basis to Taxpayer under the terms of the PPA, with the remainder being sold to wholesale purchasers pursuant to the IOA.

Transferor does not anticipate the need to purchase power from Taxpayer; however, Transferor certifies that if such purchases are made during the initial 10–year term of the PPA, such purchases are not expected to exceed 5 percent of the projected total power flows over the Interconnection Facilities.

Taxpayer further represents that the characteristics described below are present with respect to the contemplated contributions by Transferor to Taxpayer. First, the Interconnection Facilities contributed by Transferor to Taxpayer will become a permanent part of Taxpayer's transmission system. Second, the contribution is not compensation for services provided for Transferor by Taxpayer. Third, the contribution is a bargained-for-exchange because Taxpayer and Transferor entered into the necessary agreements willingly and at arm's length. Fourth, the contribution will foreseeably result in a benefit to Taxpayer commensurate will its value because the Interconnection Facilities will become part of its transmission system. Fifth, the Interconnection Facilities will be used by Taxpayer in its trade or business to produce income.

RULING REQUESTED

Taxpayer requests the Service to rule that the transfer of the Interconnection Facilities by Transferor to Taxpayer will not be a contribution in aid of construction (CIAC) under §118(b) and will be excludable from Taxpayer's gross income as a contribution to capital under § 118(a).

LAW AND ANALYSIS

Section 118(a) provides that in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Section 118(b), as amended by § 824(a) of the Tax Reform Act of 1986 (the 1986 Act), provides that for purposes of exclusion under § 118(a), except as provided in § 118(c), a contribution to the capital of taxpayer does not include any CIAC or any other contribution as a customer or potential customer.

Section 1.118–1 of the Income Tax Regulations provides, in part, that § 118 applies to contributions to capital made by persons other than shareholders. However, the exclusion does not apply to any money or property transferred to the corporation in consideration for goods or services rendered, or to subsidies paid to induce the taxpayer to limit production.

Notice 88–129, 1988–2 C.B. 541, as modified by Notice 90–60, 1990–2 C.B. 345, provides specific guidance with respect to the treatment of certain payments or transfers of property to regulated public utilities by qualifying small power producers and qualifying cogenerators (collectively, Qualifying Facilities), as defined in section 3 of the Federal Power Act, as amended by section 201 of PURPA.

The amendment of § 118(b) by the 1986 Act was intended to require utilities to include in income the value of any CIACs made to encourage the provision of services by a utility to a customer. See H.R. Rep. No. 841, 99th Cong., 2d Sess. 324 (1986). In a CIAC transaction, the purpose of the contribution of property to the utility is to facilitate the sale of power by the utility to a customer. In contrast, the purpose of the contribution by a Qualifying Facility to a utility is to permit the sale of power by the Qualifying Facility

to the utility. Accordingly, the fact that the 1986 amendments to § 118(b) render CIAC transactions taxable to the utility does not require a similar conclusion with respect to transfers from Qualifying Facilities to utilities.

Notice 88–129 provides, in part, that with respect to transfers made by a Qualifying Facility to a utility exclusively in connection with the sale of electricity by the Qualifying Facility to the utility, a utility will not realize income upon transfer of interconnection equipment (intertie) by a Qualifying Facility. The possibility that an intertie may be used to transmit power to a utility that will in turn transmit the power across its transmission network for sale by the Qualifying Facility to another utility (wheeling) shall not cause the contribution to be treated as a CIAC.

Further, the notice provides, in part, that a transfer from a Qualifying Facility to a utility will not be treated as a Qualifying Facility transfer (QF transfer) under this notice to the extent the intertie is included in the utility's rate base. Moreover, a transfer of an intertie to a utility will not be treated as a QF transfer under this notice if the term of the power purchase contract is less than ten years.

The notice also provides, in part, that a utility that constructs an intertie in exchange for a cash payment from a Qualifying Facility pursuant to a PURPA contract will be deemed to construct the property under contract and will recognize income from the construction in the same manner as any other taxpayer constructing similar property under contract. Subsequent to the construction of the property, the Qualifying Facility will be deemed to transfer the property to the utility in a QF transfer that will be treated in exactly the same manner as an in-kind QF transfer.

In the instant case, the transfer of the Interconnection Facilities is subject to the guidance set forth in Notice 88–129 and Notice 90–60 for the following reasons: (1) the Facility is a PURPA qualified facility; (2) Transferor and Taxpayer have entered into a long-term PPA with an initial term of 10 years; (3) the Interconnection Facilities will be used predominantly in connection with the sale of electricity by Transferor to the Taxpayer pursuant to the long-term PPA; (4) the transfer of the Interconnection Facilities by Transferor to Taxpayer will not be included in Taxpayer's rate base; and (5) no more than 5 percent of the projected total power flow over the Interconnection Facilities will flow to Transferor during the first ten taxable years of Taxpayer, beginning with the year in which the Interconnection Facilities are placed in service.

Accordingly, based solely on the representations and the relevant law set forth above, we rule that the transfer of the Interconnection Facilities by Transferor to Taxpayer meets the safe harbor requirements of Notice 88–129, and therefore, will not be a CIAC under § 118(b). However, Taxpayer will be required to recognize income attributable to the receipt of the transferred property if the safe harbor is terminated. See the provisions of Notice 88–129.

Next, we must decide whether the contribution qualifies as a contribution to capital under § 118(a).

The legislative history of § 118 provides, in part, as follows:

> This [§ 118] in effect places in the Code the Court decisions on the subject. It deals with cases where a contribution is made to a corporation by a governmental unit, chamber of commerce, or other association of individuals having no proprietary interest in the corporation. In many such cases because the contributor expects to derive indirect benefits, the contribution cannot be called a gift; yet the anticipated future benefits may also be so intangible as to not warrant treating the contribution as a payment for future services.

S. Rep. No. 1622, 83d Cong., 2d Sess. 18–19 (1954).

In Detroit Edison Co. v. Commissioner, 319 U.S. 98 (1943), the Court held that payments by prospective customers to an electric utility company to cover the cost of extending the utility's facilities to their homes, were part of the price of service rather than contributions to capital. The case concerned customers' payments to a utility company for the estimated cost of constructing service facilities (primary power lines) that the utility company otherwise was not obligated to provide. The customers intended no contribution to the company's capital.

Later, in Brown Shoe Co. v. Commissioner, 339 U.S. 583 (1950), the Court held that money and property contributions by community groups to induce a shoe company to locate or expand its factory operations in the contributing communities were nonshareholder contributions to capital. The Court reasoned that when the motivation of the contributors is to benefit the community at large and the contributors do not anticipate any direct benefit from their contributions, the contributions are nonshareholder contributions to capital. Id. at 591.

Finally, in United States v. Chicago, Burlington & Quincy Railroad Co., 412 U.S. 401 (1973), the Court, in determining whether a taxpayer was entitled to depreciate the cost of certain facilities that had been funded by the federal government, held that the governmental subsidies were not contributions to the taxpayer's capital. The Court recognized that the holding in Detroit Edison Co. had been qualified by its decision in Brown Shoe Co. The Court in Chicago, Burlington & Quincy Railroad Co. found that the distinguishing characteristic between those two cases was the differing purpose motivating the respective transfers. In Brown Shoe Co., the only expectation of the contributors was that such contributions might prove advantageous to the community at large. Thus, in Brown Shoe Co., since the transfers were made with the purpose, not of receiving direct services or recompense, but only of obtaining advantage for the general community, the result was a contribution to capital.

The Court in Chicago, Burlington & Quincy Railroad Co. also stated that there were other characteristics of a nonshareholder contribution to capital implicit in Detroit

Edison Co. and Brown Shoe Co. From these two cases, the Court distilled some of the characteristics of a nonshareholder contribution to capital under both the 1939 and 1954 Codes. First, the payment must become a permanent part of the transferee's working capital structure. Second, it may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee. Third, it must be bargained for. Fourth, the asset transferred foreseeably must benefit the transferee in an amount commensurate with its value. Fifth, the asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect.

The proposed transfer of the Interconnection Facilities by Transferor to Taxpayer possesses the characteristics of a nonshareholder contribution to capital as described in Chicago, Burlington & Quincy Railroad Co. First, the Interconnection Facilities contributed by Transferor to Taxpayer will become a permanent part of Taxpayer's transmission system. Second, the contribution is not compensation for services provided for Transferor by Taxpayer. Third, the contribution is a bargained-for-exchange because Taxpayer and Transferor entered into the necessary agreements willingly and at arm's length. Fourth, the contribution will foreseeably result in a benefit to Taxpayer commensurate will its value because the Interconnection Facilities will become part of its transmission system. Fifth, the Interconnection Facilities will be used by Taxpayer in its trade or business to produce income.

Therefore, Taxpayer's receipt from Transferor of the Interconnection Facilities will be a contribution to capital under § 118(a).

Accordingly, based on the foregoing analysis and the representations made by Taxpayer and Transferor, we rule that the transfer of the Interconnection Facilities by Transferor to Taxpayer will not be a CIAC under § 118(b) and will be excludable from the gross income of Taxpayer as a contribution to capital under § 118(a).

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

Sincerely,

Walter H. Woo
Senior Technician Review, Branch 5
Office of Associate Chief Counsel, Passthroughs and Special Industries

cc: Industry Director, Natural Resources (LM:NR)