Internal Revenue Service

Number: **200952014**
Release Date: 12/24/2009

Index Number: 118.02-00, 118.02-02, 118.00-00, 118.01-02

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B05
PLR-117518-09
Date: September 18, 2009

LEGEND:

Parent =
Utility =
County =
Project 1 =

Project 2 =

Authority =

Bonds =

State =
Agency =
Agreement =
Customer =

Dear :

This letter responds to a letter, dated March 27, 2009, and subsequent correspondence, submitted on behalf of Parent by its authorized representative, requesting a ruling under section 118 of the Internal Revenue Code.

FACTS

Utility is a subsidiary of Parent and a member of Parent's affiliated group that files a consolidated return. Utility is in the business of transmitting and distributing electric power.

State and County have decided to proceed with Project 1 and Project 2. The purpose of Project 1 and Project 2 is to improve traffic flow. Project 1 and Project 2 will be undertaken simultaneously in the interests of efficiency.

State has decided that Authority is responsible for Project 1. As part of Project 1, Authority will make payments and transfer property to Utility for the purpose of undergrounding the existing overhead electrical lines and related equipment. The money will come from Bonds and from State for this purpose. No money will come from Agency under the Agreement for this purpose.

County's purpose for the undergrounding of the existing overhead electrical lines and related equipment is to improve community aesthetics and public safety. The undergrounding of the existing overhead electrical lines and related equipment does not directly benefit particular customers or potential customers of Utility in their capacity as customers. According to County, Project 1 is not a condition for Project 2 and Project 1 would have occurred regardless of Project 2.

State has decided that Authority is also responsible for Project 2. Utility will provide new underground electrical lines and related equipment for Project 2 and Customer. Authority will receive money from various governmental entities, including Agency under the Agreement, for this purpose. The provision of new underground electrical lines and related equipment for Project 2 will directly benefit Customer in its capacity as a customer of Utility.

Parent represents the following under penalties of perjury: 1. Parent and Authority will enter into separate contracts for Project 1 and Project 2. 2. Parent will separately account for Project 1 and Project 2 for financial accounting and regulatory accounting purposes. 3. New customers not including Customer will be connected to the undergrounded electrical lines and related equipment for Project 1 if they request service. 4. The capacity of the undergrounded electrical lines and related equipment for Project 1 will be the same as the capacity of the existing overhead electrical lines and related equipment before undergrounding. 5. Customer will not receive any electricity from the undergrounded electrical lines and related equipment for Project 1. 6. The undergrounded electric lines and related equipment for Project 1 and Project 2 will be placed in separate duct banks and in separate trenches. 7. The excavation work for Project 1 and Project 2 is being done concurrently to minimize disruption to the commuting public. 8. The undergrounded electric lines and related equipment for Project 1 will be installed much sooner than the undergrounded electric lines and related equipment for Project 2.

Parent requests a ruling that the payments and transfers of property by Authority to Utility for Project 1 for the purpose of undergrounding the existing overhead electrical lines and related equipment are not a contribution in aid of construction (CIAC) under section 118(b) and are a contribution to the capital of Utility under section 118(a). Parent does not request a ruling for Project 2.

LAW AND ANAYSIS

Section 61(a) and section 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) provides that for section 118(a) purposes, the term “contribution to the capital of the taxpayer” does not include any CIAC or any other contribution as a customer or potential customer.

The House Ways and Means Committee Report for the Tax Reform Act of 1986 explains that property, including money, is a CIAC (rather than a capital contribution) if it is transferred to provide or encourage the provision of services to or for the benefit of the person transferring the property. H.R. Rep. No. 426, 99th Cong., 1st Sess. 644 (1985), 1986-3 (Vol. 2) C.B. 644 (the House Report). A utility has received property to encourage the provision of services if the receipt of the property is a prerequisite to the provision of the services; if the receipt of the property results in the provision of services earlier than would have been the case had the property not been received; or if the receipt of the property otherwise causes the transferor to be favored in any way. However, a transfer of property is not a CIAC where it is clearly shown that the benefit of the public as a whole was the primary motivating factor in the transfer.

Notice 87-82, 1987-2 C.B. 389, provides that a payment received by a utility is not a CIAC if it does not reasonably relate to the provision of services by the utility or for the benefit of the person making the payment, but rather relates to the benefit of the public at large. Notice 87-82 provides as an example of a payment benefiting the public at large a relocation payment received by a utility under a government program to place utility lines underground. In that situation, the relocation payment is not considered a CIAC where the relocation is undertaken for purposes of community aesthetics and public safety and does not directly benefit particular customers of the utility in their capacity as customers.

The payments and transfers of property by Authority to Utility for Project 1 for the purpose of undergrounding the existing overhead electrical lines and related equipment will benefit the public at large primarily by improving community aesthetics and public safety. Therefore, we conclude that the payments and transfers of property by Authority to Utility for Project 1 for the purpose of undergrounding the existing overhead electrical lines and related equipment fall within the public benefit exception described in the House Report and in Notice 87-82 and are not a CIAC under section 118(b).

Next, we must decide whether the payments qualify as a contribution to capital under section 118(a).

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

> This [section 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, 83rd 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, 413 (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 payments and transfers of property by Authority to Utility for Project 1 for the purpose of undergrounding the existing overhead electrical lines and related equipment contain the characteristics of a nonshareholder contribution to capital described in Chicago, Burlington & Quincy Railroad Co.. Therefore, we conclude that the payments and transfers of property by Authority to Utility for Project 1 for the purpose of undergrounding the existing overhead electrical lines and related equipment are a contribution to the capital of Utility under section 118(a).

CONCLUSION

Accordingly, based on the foregoing analysis and the representations made, we conclude that the payments made by Authority to Utility and transfers of property from Authority to Utility for Project 1 for the purpose of undergrounding the existing overhead electrical lines and related equipment are not a CIAC under section 118(b) and are a contribution to the capital of Utility under section 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. Specifically, we express no opinion regarding Project 2.

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

In accordance with the power of attorney on file with this ruling request, a copy of this letter is being sent to Parent's authorized representative.

Sincerely,

Paul F. Handleman

PAUL F. HANDLEMAN
Chief, Branch 5
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):
Copy of this letter
Copy for section 6110