Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200133036**
Release Date: 8/17/2001
Index Number: 118.01-02

Person to Contact:

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Refer Reply To:
CC:PSI:5-PLR-112988-01
Date:
May 22, 2001

LEGEND:

Taxpayer =

County A =

City B =

City C =

City D =

City E =

City F =

Organization G =

Organization H =

Area I =

Area J =

Company K =

Boulevard L =

Street M =

Avenue N =

Avenue N =

Building 1 =

Building 2 =

a =

b =

$c =

$d =

$e =

$f =

g =

Dear :

This letter responds to your authorized representative's letter dated February 26, 2001, requesting a letter ruling concerning whether the payment received by the Taxpayer for the relocation of certain power lines is a nonshareholder contribution to capital excludable from income under section118(a) of the Internal Revenue Code.

Taxpayer represents that the facts are as follows:

FACTS:

The Taxpayer is an operating public utility that provides electric service in County A. The Taxpayer provides electricity to approximately g customers in the communities of City B, City C, City D, City E, City F, and adjoining areas. Service is also provided to Organization G and Organization H at Area I at Area J.

Building 1 has been built on Boulevard L in City B. The property is located between Boulevard L on the west and Street M on the east. The south border is Avenue N and the north border is the property line of Building 2. The completion of Building 1 has significantly increased the flow of traffic on all these surface streets. County A required, as a condition for granting a building permit to Company K, that an additional lane for decelerating must be added to Avenue N to improve public safety and vehicular traffic. This additional lane was not intended to serve as an additional entrance to Building 1 but instead will facilitate and maintain the flow of traffic on Avenue N.

There were power lines running parallel to Avenue N and adjacent to the Company K's construction site. These power lines were located in the space that was to become the road expansion. Therefore, in order to widen Avenue N, the Taxpayer needed to re-

locate the power lines in order to continue to provide service to its existing customers.

Company K granted an easement to the Taxpayer to allow it to relocate the power lines on Company K's property so that the lines continued to run parallel to Avenue N. In accordance with City B's Municipal Code (Municipal Code), the replacement power lines were located underground. The Municipal Code specifically provides that for power lines which are at least a feet in length, a utility will construct, operate and maintain underground lines along public streets, roads and highways ...whenever it is necessary to replace an existing overhead distribution line." In the case of power lines which are at least a feet in length, a utility may only apply for the continuing overhead service where a majority of the customers adjoining the line do not agree to the placement of underground lines.

The Taxpayer was granted the authority to relocate the power lines along Avenue N pursuant to a Line Relocation Agreement (Agreement), dated b, between the Taxpayer and Company K. The Agreement stated Company K was required to provide a cash advance of $c to the Taxpayer at the time the agreement was executed and an additional amount at the completion of the line relocation should additional costs be incurred. If the line relocation was less than $c then the Taxpayer would refund to Company K the difference between the actual cost and the $c advance provided by Company K. Company K paid the Taxpayer d at the execution of the Agreement. The final cost of the power line relocation was $e and Company K paid the additional amount of $f to the Taxpayer (i.e., the difference between the original payment of $d and the final cost).

The regulatory commissions having regulation jurisdiction over the Taxpayer will not permit Taxpayer to include the amounts received from Company K in Taxpayer's rate base for ratemaking purposes. Therefore, Taxpayer will not be permitted to earn a return on the amounts it receives from Company K. Thus, although Taxpayer will continue to earn a return on the power lines based upon its net depreciated original cost before relocation, Taxpayer will not earn a return on any incremental value based upon the costs of relocating the lines.

RULING REQUESTED:

The Taxpayer requests that the transfer of the money from Company K to the Taxpayer will be treated as a nontaxable contribution to capital under section 118(a) of the Internal Revenue Code.

LAW AND ANALYSIS:

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. Section118(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 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).

In general, the amendment made by § 824 of the 1986 Act to §118 was intended to require a regulated public utility to include in income the value of any CIAC made to encourage the provision of services by the utility to a customer. As a result under the 1986 Act, all CIACs, even those received by a regulated public utility such as Taxpayer are includable in the gross income of the receiving corporation. The House Ways and Means Committee Report (House Report) states that property, including money, is a CIAC, rather than a contribution to capital, if it is contributed to provide or encourage the provision of services to or for the benefit of the person making the contribution. H.R. Rep. No. 426, 99th Cong., 1st Sess. 644 (1985), 1986-3 (Vol. 2) C.B. 644.

A utility is considered as having received property to encourage the provision of services if any one of the following conditions is met: (1) the receipt of the properties is a prerequisite to the provision of the services; (2) the receipt of the property results in the provision of services earlier than would have been the case had the property had not been received; or (3) the receipt of the property otherwise causes the transferor to be favored in any way. The House Report also states that the repeal of the special exclusion does not affect transfers of property that are not made for the provision of services, including situations where it is clearly shown that the benefit of the public as a whole was the primary motivating factor in the transfers. H.R. Rep. No. 426, 99th Cong., 1st Sess. 644-45 (1985), 1986-3 (Vol. 2) C.B. 644-45.

Notice 87-82, 1987-2 C.B. 389, provides additional guidance on the treatment of

CIACs. Notice 87-82 follows the language from the House Report and states that a payment received by a utility that 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, is not a CIAC. In Notice 87-82, an example of a payment benefitting the public at large is a relocation payment received by a utility under a government program to place utility lines underground. In that situation, the relocation is undertaken for either reasons of community aesthetics or in the interest of public safety and does not directly benefit particular customers of the utility.

In Brown Shoe Co. v. Commissioner, 339 U.S.583 (1950), 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 339 U.S. at 591, 1950-1 C.B. at 41.

In United States v. Chicago, Burlington & Quincy Railroad Co., 412 U.S. 401, 413 (1973), the Court articulated five characteristics of a nonshareholder contribution to capital. 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 may 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.

In the present case, County A required as a condition for granting a building permit to Company K an additional decelerating lane for enhancing public safety and vehicular traffic efficiency. To build the additional lane, power lines had to be relocated underground in conformity with City B's Municipal Code. It is clear that the relocation of the power lines to facilitate the construction of the additional traffic lane will promote public safety. Accordingly, we conclude that the payment to Taxpayer for the relocation falls within the public benefit exception described in the House Report and Notice 87-82, and will not be treated as a CIAC under § 118(b). Furthermore, the payment to Taxpayer meets the five characteristics of a nonshareholder contribution to capital stated in United States v. Chicago, Burlington & Quincy Railroad Co.

Based solely on the foregoing analysis and the representations made by Taxpayer, we rule as follows:

The payment received by Taxpayer for the relocation of the power lines is not a CIAC under § 118(b) and qualifies as a nonshareholder contribution to the capital of Taxpayer 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.

In accordance with the power of attorney filed with this request, we are sending copies of this letter ruling to your authorized representative. This ruling is directed only tot he taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely yours,
Walter H. Woo
Senior Technician Reviewer
Branch 5
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: 6110 copy