Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200133037**
Release Date: 8/17/2001
Index Number: 118.01-02

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Refer Reply To:
PLR-111584-01/CC:PSI:B5

Date:
May 22, 2001

LEGEND

Taxpayer =

State A =

City B =

Company C =

City D =

Boulevard E =

Street F =

Commission G =

Line H =

Job I =

Area J =

$a =
b =
$c =
d =
e =
f =

This letter responds to your authorized representative's letter dated February 12, 2001, requesting a letter ruling concerning whether the payment received by Taxpayer for the relocation of a underground gas transmission line is a nonshareholder contribution to capital excludable from income under § 118(a) of the Internal Revenue Code. Taxpayer represents that the facts are as follows:

FACTS:

Taxpayer is an investor-owned public utility incorporated in State A. Taxpayer is a natural gas transmission and distribution public utility serving residential, commercial, industrial, electrical utility generation and wholesale customers in the southern and central parts of State A. Taxpayer is subject to the regulation of Commission G. Taxpayer is a wholly-owned subsidiary of Company C, a company incorporated in State A, with whom it files a consolidated return on a calendar year basis using the accrual method of accounting. Taxpayer is under the audit jurisdiction of the Area Director of City B.

City D is constructing a bus transfer station facility for the patrons of the ten transit routes serving the entire Area J. The facility is located in City D on Boulevard E, west of Street F. The facility will provide bus-to-bus transfers by allowing several buses to converge on the location at one time. It is expected that the facility will reduce travel time by an estimated average of fifteen minutes for cross-town trips and will allow for an annual reduction of more than 96,000 bus miles. City D is the owner of the real property on which the bus transfer facility will be located and it will own the facility upon its completion.

The development of the line transfer facility in City D will require the relocation of a national gas pipeline, approximately f feet from the bus transfer facility. The gas line is an intrastate transmission pipeline and referred to by Taxpayer as Line H. The relocation is referred to by Taxpayer as Job I. The gas line is a high pressure conduit pipeline that transports gas from one substation to another. City D has determined that the gas line must be relocated off of the project site for safety reasons. The relocation is not a condition for service from the gas line to City D by Taxpayer. No customers are served from this line. Accordingly, the gas line will not supply natural gas to the facility, nor will City D derive any benefit, or be favored in any way, as a result of this relocation.

City D has been requested to reimburse Taxpayer for the cost to relocate the gas line, including any tax imposed pursuant to Internal Revenue Code Section 118(b). The contract for the relocation provides that City D will pay Taxpayer an estimated total of $a for the relocation. As part of the aforementioned cost for moving the gas line, Taxpayer has assessed the City a b contribution in aid of construction ("CIAC") tax gross-up of $c. Taxpayer is requiring City D to pay the full amount of the relocation, including the CIAC, in advance, and construction is scheduled to begin in d and be completed in e.

Commission G does not allow Taxpayer to add amounts received from City D in Taxpayer's rate base for rate-making purposes, rather the cost is treated as income. As a result, Taxpayer will not earn a return on the funds it receives from City D to relocate the line.

Taxpayer also represents that: (1) the relocated gas line remain a permanent part of Taxpayer's working capital structure; (2) the payment by City D to Taxpayer is not compensation for services; (3) the payment is a bargained for exchange for the relocation project; (4) the payment will result in new equipment as part of Taxpayer's natural gas transmission system commensurate with the amount of funds paid by City D; and (5) the relocated gas line will continue to be used by Taxpayer in the course of its business to produce income.

RULINGS REQUESTED

Taxpayer requests the Internal Revenue Service to rule that the payment received by Taxpayer for the relocation of the gas line is a non-shareholder contribution to capital under Internal Revenue Code Section 118(a) and is not taxable CIAC under Internal Revenue Code Section 118(b).

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 or 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 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, 83rd 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 property 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 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, if 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.

In the present case, City D has determined that the gas line must be relocated off the project site for purposes of public safety prior to commencement of construction. It is clear the relocation of gas lines running through the project site 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 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 gas line 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 to the 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