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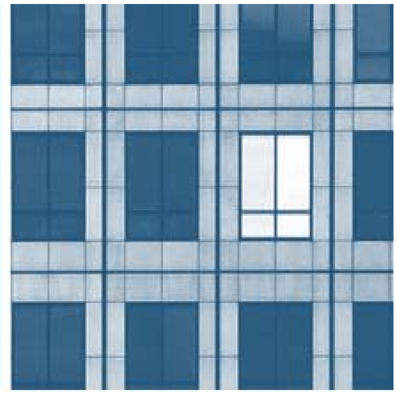
On the Subject



Energy & Commodities Advisory

July 21, 2010

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Private Letter Ruling Issued Addressing the Public Benefit Exception Under IRC Section 118(b) Relating to Contributions in Aid of Construction

A Private Letter Ruling (PLR), particularly important to utility companies that receive payments to facilitate the relocation of transmission equipment, was recently issued by the Internal Revenue Service (IRS). The ruling concerns "non-shareholder contributions to capital" under Section 118 of the Internal Revenue Code (Code). Under Code Section 118(a), in the case of a corporation, gross income *does not* include any contribution to the capital of the taxpayer. However, under Code Section 118(b), there is an exception to this income exclusion applicable to a "contribution in aid of construction" (CIAC) or any other contribution as a customer or potential customer. A CIAC or other contribution to a corporation as a customer or potential customer is includible in the recipient taxpayer's income. The legislative history of Section 118 and IRS Notice 87-82 make it clear that a transfer of property is not a CIAC if the taxpayers can show that the primary motivating factor for a contribution to a corporation was to benefit the public as a whole. Rulings favorable to taxpayers in this area have been uncommon in recent years; only two PLRs granting the public benefit exception to a utility have been issued since 2007.

In the PLR, the company (Taxpayer) requested that the IRS rule that contributions to the Taxpayer from a county government (County) in order to complete a road expansion project would not be taxable CIACs, but rather constituted non-shareholder contributions to capital excludable from income. The Taxpayer has electrical transmission lines that need to be moved for the road project to be completed, and the County will pay for this relocation from a state program for road improvement projects. No new capacity will be created, and no new areas will be served as a result of the relocation. The state program is being funded in part by contributions from companies that intend to develop nearby properties in the future. While the residents of these future developments might become customers of the Taxpayer, they will not be served by the relocated transmission lines.

The PLR concludes that the payments by the County to relocate the transmission lines for the purpose of building a public highway fall within the public benefit exception to CIAC treatment under Section 118(b). After determining that the County payments were not CIACs, the IRS ruled that the payments fit the definition of non-shareholder contributions to capital under Code Section 118(a). Therefore, the payments will be excludable from the Taxpayer's income.

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Hayes Holderness, summer associate, also contributed to this newsletter.

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