INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE-MIS No.: TAM-127547-04, CC:PSI:B05

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No.:
Years Involved:
Date of Conference:

LEGEND:

Taxpayer	=
Transferor	=
State	=
City	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Date 1	=
Date 2	=
Campus	=
Legislation	=
Act	=

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

ISSUE:

Whether the $a payment made by Transferor to Taxpayer in Year 1 to relocate and remove electric transmission lines is a nonshareholder contribution to capital under § 118(a) of the Internal Revenue Code.

CONCLUSION:

The $a payment from Transferor to Taxpayer in Year 1 for the relocation and removal of electric transmission lines on the site of the Campus is a taxable contribution in aid of construction (CIAC) under § 118(b).

FACTS:

Taxpayer is an investor-owned public utility incorporated in State and is engaged primarily in the generation, transmission, and distribution of electrical energy.

Transferor, a tax-exempt state-chartered public university, which is located in City, owns a b acre site adjacent to the main campus. Transferor is developing this site and has named it the Campus. This new campus is a planned mixed-use site for university, corporate, and government facilities. The Campus will also include residential housing (homes, apartments, and condominiums), a hotel, a conference center, a golf course, and retail space. Transferor describes the development as a place where university faculty and students can interact with the government and private industry tenants.

In Year 2, State enacted Legislation which authorized the issuance of tax-exempt revenue bonds to fund the development of the Campus. The line relocation project was financed, in Year 3, through Transferor's issuance of these tax-exempt bonds.

The Campus site had c electric transmission lines running through the middle of the property from north to south on a d foot-wide corridor. Taxpayer and Transferor entered into a Line Relocation Agreement on Date 1 to relocate the transmission lines. The Line Relocation Agreement specifically provides that at the request of Transferor, the c lines owned by Taxpayer and located on the Campus each require relocation in order to accommodate development plans by Transferor within the Campus. The agreement further provides that as part of such relocation e of the lines will be rerouted to the perimeter of the Campus and a de-energized line will be removed.

Taxpayer removed the old lines running through the center of the Campus and replaced them with new lines constructed around the perimeter of the property. This new construction did not result in any increase in electrical capacity or other operation improvement, and the capacity of each energized line remained unchanged. Prior to the relocation, Transferor already received electrical service from Taxpayer, and the Campus already had access to electrical service. The line relocation project was completed to enhance the overall campus layout by clustering multi-disciplinary research and providing an attractive community setting for the faculty, students, and affiliates.

The project was to be completed by Date 2, and Taxpayer was to receive a series of payments totaling $f. In Year 1, Taxpayer received the $a at issue and, in Year 4, the remainder.

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. 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, 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 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** (emphasis added). 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 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, notwithstanding the fact that Transferor, a public university, is developing the Campus in furtherance of its mission as an educational institution, the relocation payments made to Taxpayer resulted in a direct benefit to Transferor. The existing transmission lines would have bifurcated the property and disfigured the prime area for development of the site. The relocation of the lines made possible the optimal development of the Campus. Thus, based solely upon the above facts and Taxpayer's representations as set forth above, we conclude that the $a payment from Transferor to Taxpayer in Year 1 for the relocation and removal of electric transmission lines on the site of the Campus is a taxable CIAC under § 118(b) and therefore not excludable from the gross income of Taxpayer as a nonshareholder contribution to capital under § 118(a).

CAVEAT(S):

No opinion is expressed or implied regarding the application of any other provision of the Code or regulations. A copy of this technical expedited advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.