

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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Index (UIL) No.: 61.00-00

CASE-MIS No.: TAM-134061-03/CC: ITA: B05

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No

Years Involved:

Date of Conference:

LEGEND:

Taxpayer	=
Tax Year	=
State A	=
Affiliate 1	=
Affiliate 2	=
Affiliate 3	=
Year 1	=
Year 2	=
Act	=
Assets	=
Department	=
Date 1	=
Date 2	=
Date 3	=
X percent	=
Y percent	=
\$A	=
\$B	=

\$C	=
\$D	=
\$E	=
\$F	=
Buyer	=
SPE	=

ISSUE:

Are certain gain proceeds from the sale of Assets excludible by Taxpayer from gross income.

CONCLUSION:

The Taxpayer may exclude the gain proceeds on the sale of Assets from gross income because the funds it received from the sale were subject to an unequivocal statutory and regulatory obligation to be paid to its customers, and thus Taxpayer did not have the unrestricted use, dominion and control over the funds.

FACTS:

Taxpayer was organized as a State A business trust, and is an exempt public utility holding company. Three of Taxpayer's wholly owned subsidiaries, Affiliate 1, Affiliate 2, and Affiliate 3 (collectively, the "Companies"), operate in the electric utility industry. Taxpayer (through its subsidiaries) served electric and gas customers in State A.

In Year 1, State A enacted Act, which restructured the electric utility industry in State A by segregating the services of generation, transmission, and distribution of power. Act was intended to serve ratepayers by moving from a framework with regulated rates to a framework under which competitive producers will supply electric power and customers will gain the right to choose their electric power supplier. It was anticipated that lower rates would result from increasing the competition and consumer choice in generation service; unbundling of prices and services; and separating generation services from transmission and distribution services. Act required electric utilities in State A to file detailed plans with Department for restructuring their operations. Pursuant to Act, power generation became a competitive, non-regulated industry for suppliers; whereas distributors, such as Affiliates 2 and 3, remained subject to federal and state regulation. Act required utility distributors to obtain and resell power to customers who chose not to buy energy from competitive energy suppliers. Utilities thus disposed of generation facilities, and therefore Act resulted in the vertical disintegration of utility companies.

In order to facilitate the transition to a competitive market place, Act permits utilities to recover prudently incurred costs associated with generation-related assets and obligations through a transition charge mechanism. Transition costs eligible for this

transition charge mechanism include unrecovered book basis in generation assets, costs to terminate or renegotiate power purchase contracts, unrecovered book basis in generation-related regulatory assets, and certain employee transition costs. To be eligible for transition cost recovery, Act required Department to verify that the electric utility company had (i) filed on or before Date 1 a plan to provide all of its retail customers the ability to purchase electricity from an alternative supplier or generation company as of Date 2; (ii) developed and will implement a plan to divest itself of its portfolio of Assets by Date 2; and (iii) developed and will implement a plan for all required, necessary, and reasonable mitigation methods to reduce potential transition costs. The plan formulated pursuant to (i) above must provide a standard service transition rate and rate reduction as required by Act.

An electric company must mitigate its transition costs if Department is to approve a company's transition charge mechanism. Under Act, the mitigation efforts include the divestiture of Assets. This requirement is met if the electric company divests its Assets by selling them in a competitive auction or in a process approved by Department or by transferring Assets to an affiliated company at a value determined to be reasonable by Department. If an electric company sells Assets, the net proceeds from the sale must be applied as an offset to the company's transition costs (including unrecovered book cost of the company's Assets). One provision in Act states as follows:

All proceeds from any such divestiture and sale of generation facilities ..., net of tax effects and less any other adjustments approved by the Department that inure to the benefit of ratepayers, shall be applied to reduce the amount of the selling electric company's transition costs.

Act's requirement that the proceeds from the sale of generating facilities reduce transition costs is consistent with established Department case law, which provides that gains on the sales or other transfers of utility property must be returned to ratepayers, typically by means of rate reductions. If the sales proceeds are held by the utility for an extended period of time, Department may require the utility to reduce rates by any earnings on the proceeds. The policy of Department thus precludes regulated utilities from benefiting from the gain, if any, on the sale of regulated property. The basis for this policy is that if ratepayers funded the purchase of property, the gain associated with the sale of such property should be returned to ratepayers over time.¹

¹ Boston Gas Company, D.P.U. 1100, at 62-65 (1982), gave the following rationale for this policy:

The [regulated utility] and its shareholders have received a return on the use of these parcels while they have been included in the rate base, and are not entitled to any additional return as a result of their sale. To hold otherwise would be to find that a regulated utility may speculate in ... utility property and, despite earning a reasonable rate of return from its customers on that property, may also

If, instead of selling Assets, a utility chose to divest by transferring its Assets to an affiliated company, the market value in excess of book value of the Assets must be applied as an offset to the utility's transition costs. The transition charge mechanism accords a restructured utility with the opportunity to be reimbursed from its customers for defined transition costs. Not only is the utility eligible to receive a dollar for dollar reimbursement for its transition costs, but it was also eligible to receive a "return" (carrying charge) on its unrecovered transition costs. Act also stipulated that a utility would be entitled to retain a portion of any mitigation amounts. This was intended as an incentive by the Department for saving money for ratepayers.

Accordingly, pursuant to Act and Department policy, if Assets are sold, the utility is required to reduce its transition costs to the same extent as the gain proceeds from the sale of Assets. This reduction, or mitigation, was accomplished by means of a residual value credit (RVC). The RVC is an amortizable credit to the fixed component of the transition charge which equates to a reduced transition charge that would otherwise be billed to customers of the utility. In summary, when generating facilities are sold, the gain proceeds from the sale reduce the company's transition costs by means of the RVC, which triggers a decrease to the transition charge billed to the ratepayers of the company. Alternatively, the net proceeds could be used to buyout burdensome, above market, power contracts thereby reducing transition costs to customers.

Companies filed a restructuring plan (the "Plan") with Department requesting approval from the state and federal energy commissions for Companies to divest themselves of Assets and power purchase contracts by using a competitive bidding process. Plan proposed to mitigate to the maximum extent possible the total amount of transition costs of Taxpayer, which would minimize the impact of the recovery of transition costs on its ratepayers. In compliance with Act, all proceeds from the divestiture and sale of Assets net of tax effects were required to be applied to reducing the amount of the Companies' transition costs. Plan was approved by regulators.

Companies reduced rates charged to all customers. Under Plan, Companies were not only authorized by Department to recover transition costs from customers, but also a rate of return in their unrecovered transition costs of X percent. Department required Affiliates 2 and 3 to reduce their transition costs by the unrecovered cost of Assets at a X percent rate, which is an exact offset to what was previously included in the transition costs. Retroactive adjustment was made reducing transition costs by any earnings on the unrecovered costs. All proceeds in excess of book would be paid to customers at the exact rate earned by those funds held in SPE.

Plan included a mitigation incentive for Companies of Y percent to be applied to that

accumulate a windfall through its sale. We find this to be an uncharacteristic risk/reward situation for a regulated utility to be in with respect to the plant in service.

portion of the mitigation that exceeded a base-case threshold. For the fixed component of the transition charge, the base-case threshold for an Asset was set at the net book value of that Asset. Y percent would be applied to the extent that mitigation (sales proceeds) exceeded book value of Assets on the date of divestiture. For the variable component of the transition charge, which consisted mainly of above market payments for power contracts, the base-case threshold was set at the estimated above market payments provided in the Plan. Thus, the mitigation incentive for reductions in the variable component of the transition charge was set at Y percent of the amount by which the Companies reduce their above market payments. The Companies have received \$A in mitigation incentives due to the sale of Assets.

In Tax Year, Companies sold substantially all of Assets to Buyer for an amount, net of certain adjustments, of \$B. Buyer assumed all future material liabilities associated with Assets. Assets had a book value of \$C. In Tax Year, Department approved Taxpayer's proposal to establish SPE, a special purpose affiliate to administer and invest the above-book net proceeds from the sale of the Assets. Department required that the proceeds be invested in a portfolio of conservative securities. The principal amount and income earned were to be used to reduce the transition costs that would otherwise be billed to Companies' customers. The funds being managed by SPE represent the book gain (*i.e.*, the excess of sales proceeds over book basis) from the sale of Companies' Assets. The two main deposits that make up the total amount of funds placed under SPE's management consist of \$D and \$E. Any investment income that SPE earns on these funds is used to further mitigate transition costs by means of the RVC.

Taxpayer has taken the position that under State A's law SPE can only deal with its parent company and not with otherwise affiliated companies. Thus, Taxpayer acts as a "go-between" entity where funds flow through Taxpayer without any financial impact. For instance, Affiliate 1 paid its net sale proceeds to Taxpayer, which contributed the funds to SPE. SPE holds and invests the funds. When requested, SPE paid the funds to Taxpayer, which in turn paid the amounts to Affiliate 1. Payments were made to Affiliates 1 when that affiliate made or would make Department-approved expenditures to or on behalf of their customers or when the RVC reduced the transition charge. As Companies use the RVC to reduce the monthly transition charge, SPE thus disburses an equivalent amount to Companies via Taxpayer in accordance with the law of State A. If one of the Companies elects, with Department approval, to buyout a power contract or to buydown a regulatory asset, SPE transfers an equivalent amount to Taxpayer who in turn transfers such monies to that Company. Department reviews the operation and investments of SPE. SPE files financial reports with Department on a regular basis.

Taxpayer filed a Form 8275 Disclosure Statement with its Tax Year Form 1120 for the consolidated return of Taxpayer. In the Disclosure Statement, Taxpayer asserted that Companies have excluded from taxable income gains related to the sale of Assets because they do not have complete dominion over the proceeds from the sale of

Assets; that Department maintains absolute authority over the disposition of Assets and the use of the proceeds; that no economic benefit accrues to Companies from the sale of Assets; and that all available proceeds, including interest, accrue to the benefit of customers. Companies did report \$F of depreciation recapture.

LAW AND ANALYSIS:

Section 61 of the Internal Revenue Code defines gross income as “all income from whatever source derived.” Section 61(a)(3) specifically refers to “gains derived from dealings in property” as an item of gross income. See also Treas. Reg. § 1.61-1(a). A taxpayer must recognize the gain from the sale of property, unless the gain is otherwise excluded by law. Treas. Reg. § 1.61-6.

However, the above definition must be considered in the context of the claim of right doctrine, which has evolved from cases such as North American Oil Consolidated v. Burnet, 286 U.S. 417 (1932), where the United States Supreme Court held that “[i]f a taxpayer receives earnings under a claim of right and without restrictions as to its disposition, he has received income” and accordingly must be taxed on it. Id. at 424. However, where a taxpayer is obligated to dispose of the money it receives in a certain way, accruing no benefit to itself, the funds are considered to be excluded from the taxpayer's gross income. See Central Life Assurance Society v. Commissioner, 51 F.2d 939, 941 (8th Cir. 1931). Accordingly, for amounts to be included in gross income, the taxpayer must have both a claim of right to such amounts and they must be received without restriction.

While the Supreme Court has not directly addressed the precise issue presented by this case, it has addressed the income tax treatment of amounts received by utilities in other circumstances. In Commissioner v. Indianapolis Power & Light Co., 493 U.S. 203 (1990), an electric utility (“IPL”) required certain customers with suspect credit to make deposits to insure prompt payment of future utility bills. The customer was entitled to a refund of the deposit after making timely payments for several months or satisfying a credit test. The customer could choose to take the refund by cash or check or to apply the refund against future bills. The deposits were commingled with other receipts and at all times were subject to IPL's unfettered use and control. The Service argued the deposits were advance payments immediately includable in income; while IPL argued they were analogous to loans and as such not taxable. The Court reasoned that the distinction between advance payments and loans was one of degree rather than kind. Id. at 208. While both bestow economic benefits to the recipient, economic benefits qualify as income only if they are “undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.” Id. at 209, quoting Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955). The key to determining whether a taxpayer enjoys “complete dominion” over a given sum is whether the taxpayer “has some guarantee that he will be allowed to keep the money.” Indianapolis Power and Light, 493 U.S. at 210. The proper focus is on the rights and obligations of the parties at the time the payment was made. Id. at 209. Because

IPL's customers controlled the ultimate disposition of the deposit and had not committed to purchasing any electricity at the time the deposit was made, the Court found that IPL had no guarantee that it would be allowed to keep the money and held that the deposit amount was not income.

A long line of cases have applied the above principles in determining whether amounts received by a taxpayer are includible in gross income at the time of receipt. These cases have consistently held that when a taxpayer receives funds with an unequivocal statutory or regulatory duty to repay the funds, and thus the taxpayer receives no economic benefit from the funds, the funds are not includible in the gross income of the taxpayer at the time of receipt. See Mutual Telephone Co. v. United States, 204 F.2d 160 (9th Cir. 1953) (taxpayer, a telephone utility, was authorized by its regulatory commission to collect additional funds from customers in 1941 and 1942 through increased rates in order to curtail demand. The commission indicated that the additional funds were not being received as additional revenue or collected for the taxpayer's benefit, nor could the amounts collected inure to the benefit of the taxpayer's shareholders, but rather the amounts were paid into a special account over which the commission held ultimate control until 1949. The additional amounts were held excludable from the taxpayer's gross income in 1941 and 1942; but were includible in gross income when made available to the taxpayer in 1949); Illinois Power Co. v. Commissioner, 792 F.2d 683 (7th Cir. 1986) (rate increases collected by taxpayer, a utility, from its customers pursuant to state commerce commission's order to discourage consumption were excluded from gross income in the years received because such increases were not intended to enrich, nor be retained by, the taxpayer, and because the amounts collected were required to be repaid to customers in later years even though the customers obtaining the benefit of the repayments were not the same as the customers who paid the increased rates); Houston Industries, Inc. and Subsidiaries v. United States, 125 F.3d 1442 (Fed. Cir. 1997) (fuel cost overrecoveries received by taxpayer, a utility, from its customers were held excludable from gross income because the taxpayer had a statutory obligation to repay such amounts to customers and thus did not have unrestricted dominion and control over such amounts when received. Court concluded that it did not matter whether the amounts were refunded by check to customers or offset against customers' bills since either method had the same effect and since the fuel cost system was designed to benefit the taxpayer's customers, not the taxpayer); Florida Progress Corporation & Subsidiaries v. Commissioner, 114 T.C. 587 (2000) (overrecoveries of estimated fuel and energy conservation costs held excludable from gross income of taxpayer, a utility, in the tax year received because utility did not have complete dominion and control over such amounts upon receipt. Regulatory authority required taxpayer to return overrecoveries with interest to customers; the repayment mechanism afforded taxpayer with no opportunity to benefit from overrecoveries; and taxpayer was subject to a fixed and certain liability to refund overrecoveries that was determinable at the time funds were received). See also United States v. Maryland Jockey Club of Baltimore City, 210 F.2d 367 (4th Cir.), cert. denied, 347 U.S. 1014 (1954); Michigan Retailers Association v. United States, 676 F. Supp. 151 (W.D. Mich. 1988); Electric Energy, Inc. v. United States, 13 Cl. Ct. 644

(1987); Cinergy Corp. v. United States, 55 Fed Cl. 489 (2003); Broadcast Measurement Bureau, Inc. v. Commissioner, 16 T.C. 988 (1951); Florists' Transworld Delivery Association v. Commissioner, 67 T.C. 333 (1976).

Taxpayer argues that the gain proceeds from the sale of Assets (plus the earnings thereon) should be excluded from its gross income in the year of the sale of Assets because the statutory and regulatory scheme established by State A requires that such amounts be returned to ratepayers. Consequently, the mechanism set up by Taxpayer and approved by Department provides that the economic benefits from the sale of Assets inure to the benefit of the ratepayers, not Taxpayer, and therefore the gain proceeds and the earnings thereon have been received by it subject to a substantial restriction. Accordingly, Taxpayer's position is that, pursuant to all of the above cases, the gain proceeds should be excluded from gross income.²

In Rev. Rul. 2003-39, 2003-17 I.R.B. 811, the Service accepted the holdings in Houston Industries, Florida Progress, and Cinergy Corp. and concluded that taxpayers may exclude fuel cost and energy conservation cost overrecoveries from gross income in cases involving facts substantially similar to those in these three cases. The Field, however, argues that this case does not involve facts substantially similar to those in Houston Industries, Florida Progress, and Cinergy. In fact, the Field contends that this case is distinguishable from all of the cases cited above because the facts here involve amounts received from the sale of property whereas none of the above cases involved a property sale by a taxpayer.

The Field contends that Taxpayer sold its generating assets at a gain, which is a separate and distinct taxable transaction that must be recognized, notwithstanding Taxpayer's obligation to reduce transition costs in the future. The Field cites two cases, Iowa Southern Utilities Co. v. United States, 841 F.2d 1108 (Fed. Cir.), cert denied, 488 U.S. 952 (1988), and Artnell Co. v. Commissioner, 48 T.C. 411 (1967), where courts have recognized that income must be reported when a taxpayer sells property or services for compensation, notwithstanding a taxpayer's further obligation to "refund" the money or pay the money out to a third party.

In Iowa Southern Utilities Co. v. United States, 841 F.2d 1108 (Fed. Cir.), cert. denied, 488 U.S. 952 (1988), surcharges paid by ratepayers to finance the construction of a generating station were held includible in the gross income of Iowa Southern, a utility,

² The Field and the Taxpayer agree that the mechanisms set up in the Plan do not result in a permanent impairment of the fisc. Instead, through reduced deductions, use of the RVC to reduce transition charges, or operation of other mechanisms, the government will be made whole in subsequent tax years with the result that the timing, rather than the amount, of Taxpayer's gross income ultimately is what is in issue here.

upon receipt, notwithstanding the utility's unconditional obligation to refund the amounts to customers as a negative surcharge over a 30 year period starting at the time the generating station begins operation. The court noted that the tariff sheet, which established the utility's authorized rates, provided that the charges for electric service be increased to recover the financing charges associated with the generating station's construction, which indicated that the surcharges were compensation for electric services. Id. at 1111. The Field contends that the gain proceeds received on the sale of Taxpayer's Assets should be treated no differently, that is, as income under § 61, since the proceeds were received in exchange for property rather than as compensation for electric services.

Furthermore, the Field contends that the RVC, which reduces the transition costs, should be treated like the "refunds" in Iowa Southern -- as a reduction in future income. In Iowa Southern, the court found that the taxpayer did not have an unequivocal contractual, statutory, or regulatory duty to repay the surcharges, so that it really was just the custodian of the money. Rather than a duty to repay, there was only a regulatory policy on the allowable rates for electric service, which allowed the rates to be lowered in future years to offset the increase. Id. 1111-1113. In the subject case, notes the Field, Taxpayer sold Assets at a gain. Act merely formalizes a regulatory policy, which requires rates charged to customers to be lowered in future years by the amount of the gain proceeds (by means of the RVC).

The instant case illustrates the distinction between two cases both decided by the Court of Appeals for the Federal Circuit: Iowa Southern, supra, which predated Indianapolis Power and Light, and Houston Industries, supra, which was decided after Indianapolis Power and Light. This distinction was discussed fully by that court in Houston Industries, which noted that the surcharge, i.e., rate increase, in Iowa Southern was taxable income to the utility because it was for the benefit of the utility - to finance construction of a power plant- and the utility paid no interest on the funds. More critically, unlike Indianapolis Power & Light, the court identified no "unequivocal contractual, statutory, or regulatory duty to repay" the funds. 841 F.2d at 1112. Consequently, the Federal Circuit found that, due to the absence of any independent repayment requirement, the Iowa Southern utilities had exercised dominion and control over the surcharge and derived benefit from their retention of the money, thereby requiring those sums to be included in income.

Houston Industries, which addressed the taxability of certain fuel cost overrecoveries, held that, because the taxpayer had an unconditional obligation to repay to its customers all overrecoveries received, the overrecoveries could not be characterized as income. The Court of Appeals for the Federal Circuit noted that the overrecoveries were similar in several respects to the deposits in Indianapolis Power and Light Co. First, the taxpayer in Houston Industries derived no benefit from the overrecoveries. The stated purpose of the regulatory scheme that caused the overrecoveries was to benefit the customers, not the taxpayer. Moreover, the taxpayer was required to pay interest on the overrecoveries. Further, the taxpayer had a statutory obligation to repay the

overrecoveries at the time it collected its customers' payments. Although an overrecovery could be offset by a later underrecovery, this alternative method of repayment did not affect the taxpayer's obligation to repay. While the taxpayer could not be certain, at the end of the tax years in question, of the method of repayment, its obligation to repay, with interest, was set at the time of overpayment. Consequently, under these circumstances, the taxpayer acted as a custodian of these funds, and thus, unlike the utility in Iowa Southern, was found not to be taxable on the amounts in issue.

In our view, the instant case is closer to Houston Industries than it is to Iowa Southern. First, the court in Iowa Southern specifically found that there was no statutory or regulatory duty to repay the surcharges to the utilities customers. In the instant case, Act established a statutory requirement that utilities cease vertical integration and that "all proceeds from any such divestiture and sale of generation facilities ... shall be applied to reduce the amount of the selling electric company's transition costs." Therefore, Taxpayer had a statutory and regulatory obligation to pay to its customers the amounts received from the sale of the Assets in excess of book basis, with interest. Moreover, whereas the utility in Iowa Southern did benefit from the surcharge by being permitted to retain the power generating plant financed by the surcharge (even if it did have to "refund" the surcharge in later years through lower electric charges), in this case Taxpayer divested itself of Assets and also was not permitted by Act and the longstanding regulatory policy of Department to retain the gain proceeds of the divestiture. In other words, Taxpayer could retain neither its Assets nor the full economic benefit of the gain proceeds from the sale of its Assets. Finally, in Iowa Southern the utility paid no interest on the funds raised from the surcharge, whereas in the instant case, Taxpayer must reduce transition charges dollar for dollar by the amount of earnings on the funds held in SPE.

The Field also cites Artnell in support of its position. In Artnell, the taxpayer, the owner of a baseball team, sold tickets to its baseball games in advance of the date on which such games were to be played. The taxpayer argued that it should be able to exclude the portion of advance ticket sales revenue related to federal admissions tax, city amusement tax, and the portion that must be paid to the visiting team under league rules. The court concluded that, because the ticket purchaser was liable for the federal admissions tax, the taxpayer was, pursuant to a federal statute, merely a "collector" of the tax on behalf of the United States government and, thus, the tax was excluded from the taxpayer's gross income. With regard to the city tax, the court concluded that the taxpayer was liable for the tax, not the ticket purchaser, because no provision of the city's laws or ordinances, which would make the taxpayer the agent or trustee of the city, had been brought to the court's attention. Accordingly, the court found no reason to exclude such receipts from gross income. Finally, with regard to the portion to be paid to the visiting team, the court concluded that the portion was paid to the taxpayer for playing the games and its later liability to the visiting team did not alter the taxpayer's claim to the income. Significantly, the court found that the games may not be played and, therefore, the taxpayer would not be liable for the city amusement tax or the visiting team's portion.

The Field argues that Taxpayer is in the same position as the baseball club owner in Artnell, that is, it is not a collection agent of the ratepayers with respect to the sale of Assets just as the baseball club owner was not collecting amounts as an agent of the city, the league or the opposing ball clubs. Consequently, Taxpayer should be required to include the full amount of the gain proceeds in income just as the taxpayer in Artnell was required to include all amounts in its gross income (other than the federal admissions tax). However, Artnell is distinguishable from the present case because the taxpayer there, apart from the federal admissions tax, was collecting a ticket price to which it was entitled to the entire amount. The taxpayer could charge the customer any amount it wanted for the ticket, and could increase the price of the ticket to cover the tax. Nevertheless, it was the taxpayer, not the customer, who was liable for the tax. Therefore, the taxpayer was not collecting, on behalf of the city, an amount that the ticket customer owed to the city. Instead, the taxpayer was collecting a fee to which it was entitled for the ticket. From that fee, the taxpayer later will pay its expenses, including taxes.

We find that Artnell is inapposite here, primarily because it did not involve a duty to repay an amount of funds, nor did it involve a substantial restriction on the taxpayer's dominion and control of the amounts collected from the sale of tickets. In this case, unlike the taxpayer in Artnell who was entitled to the entire ticket price, by statute and regulatory policy Taxpayer was not entitled to retain the funds it received from the sale of Assets in excess of book basis. Because it is a regulated utility selling regulated property, the gain inherent in that property belonged to its customers.

In our view, the Field's view that this case is somehow different from a long line of case authority due to the fact that the transaction in the instant case involves proceeds from the sale of property rather than fuel cost overrecoveries, surcharges, or other amounts received by a taxpayer is a distinction without a substantive difference. Whether the amounts in issue are received by a taxpayer as "gain" from dealings in property governed by §§ 61(a)(3) and 1001, or as the result of a transaction governed by some other provision in § 61, the principles enunciated in the above cases determine whether or not such amounts are includible by that taxpayer in gross income when received. In particular, the one overriding principle for determining if such amounts are includible in gross income at the time of receipt is whether the taxpayer has unrestricted dominion and control over the funds at the time of receipt such that the taxpayer "has some guarantee that he will be allowed to keep the money." Indianapolis Power and Light, 493 U.S. at 210. In the instant case, we do not think that Taxpayer has the unrestricted dominion and control over the gain proceeds received from the sale of Assets necessary for such amounts to be included in Taxpayer's gross income in Tax Year.³

Taxpayer is a regulated utility governed by Department. In the instant case, the State A

³ Taxpayer did include a portion of the gain from the sale of Assets in its gross income in Tax Year. The amount of gain that Taxpayer included in gross income was equal to the difference between adjusted tax basis and book basis of Assets, an amount to which Taxpayer acknowledged it received under a claim of right and without restriction.

legislature believed that the ratepayers of State A would benefit from unbundling the generation of electricity from its transmission and distribution. As a result, Act was designed to encourage utilities to achieve cost savings for customers, which was the rationale for the provisions dealing with the disposition of generating assets in a competitive bidding process. Like the regulations at issue in Houston Industries, supra, the purpose of Act, which resulted in the sale of Assets, was to benefit ratepayers, not Taxpayer. Although Taxpayer could select the method by which it “returned” to the ratepayers the gain proceeds from the sale of Assets, it nevertheless was required to develop a plan to return such funds, with interest, to ratepayers and that plan had to be approved and monitored by Department.

Consequently, in the instant case, we agree with Taxpayer that it received the funds in excess of Assets’ book basis under an unequivocal statutory and regulatory duty to repay the funds to its ratepayers, and thus Taxpayer received no economic benefit from those funds. Accordingly, under the cases cited above, we conclude that Taxpayer was not required to include such funds in gross income in Tax Year. See, e.g., Illinois Power Co. supra at 689, “a taxpayer is allowed to exclude from his income money received under an unequivocal contractual, statutory, or regulatory duty to repay it.”

CAVEAT:

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.