APPEALS INDUSTRY SPECIALIZATION PROGRAM

SETTLEMENT GUIDELINES

INDUSTRY: Utilities

ISSUE: ITC on Transition Property

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COORDINATED ISSUE SETTLEMENT GUIDELINE
UTILITIES INDUSTRY

ITC TRANSITION PROPERTY

STATEMENT OF ISSUES

Issue 1: Whether the "regulatory compact" or franchise under which a regulated public utility operates qualifies as a binding written supply or service contract under section 204(a)(3) of the Tax Reform Act of 1986 (the "Act").

Issue 2: Whether the property for which ITC is claimed is “readily identifiable with and necessary to” carry out a written supply or service contract within the meaning of section 204(a)(3) of the Act.

Issue 3: What are the appropriate placed in service dates for qualified transition property under section 204(a)(3) of the Act?

EXAMINATION DIVISION POSITION

In order to fall within the limited "supply or service contract" transition rule, the taxpayer must establish the following nine elements with respect to each alleged supply or service contract: (1) it must be a written contract; (2) for supply or services; (3) binding on December 31, 1985; (4) binding at all times thereafter; (5) enforceable against the taxpayer; and (6) the contract must not limit damages to a specified amount (unless the limitation is for an amount greater than or equal to 5% of the contract price). Further, with regard to the property placed in service: (7) the specifications must be "readily ascertainable" from the terms of the contract or related documents; (8) the amount of property must be "readily ascertainable" from the terms of the contract or related documents; and (9) the property must be "necessary" to carry out the terms of the contract. Section 204(a)(3) of the Act. Failure to meet even one of the above requirements is fatal to taxpayer's claim for relief from the ITC repeal in Section 211(a) of the Act.

Issue 1:

The relationship between the operating utility companies and their respective regulators is

based on an unwritten agreement of understanding between the utilities and the commissions, termed a "regulatory compact" implied from legislative and public utility commission ("PUC" or "commission") decisions. This "regulatory compact" is not a binding written contract as contemplated and required by the limited transition rule.

Further, certain documents known as "franchises" and "Certificates of Public Convenience and Necessity" ("Certificates") are not binding written contracts within the meaning of the ITC transition rules contained in Section 204 of the Act. The Certificates are general in nature and do not set forth any specific supply or service obligations, or require the utility to acquire any particular property as required by the "supply or service contact" limited transition rule. Although some Certificates impose certain general service standards on the utilities, those standards do not require the utility to acquire any specific property.

The utilities argue that Tariffs can be considered contractual arrangements under the ITC transition rules of section 204 of the Act. A tariff is a document which broadly describes the type of service a public utility may and must offer, the general terms and conditions associated with the rendering of the services, and the price the utility may charge for its services. In general, tariffs are written documents that contain standardized provisions. However, any changes in rates or regulations authorized by a PUC automatically modifies the contract, without notice to the customer. The contract period is for one month and continues from month to month, and is terminable at will by the customer.

Thus, tariffs are not written binding contracts within the strict requirements of the ITC transition rules. Instead, the tariffs are a description of the services the utilities offer and the prices the utilities may charge for those services. They are approved by the commissions, and are subject to change at any time. At most, the tariffs are limited, month-to-month agreements with customers.

The above arguments regarding whether a “regulatory compact” is a contract generally and more specifically a “supply or service contract” have been considered by the 3rd Circuit appellate court in Bell Atlantic v. United States, 99-1 USTC 50,119 (E.D. Pa.); aff’d, 224 F 3d 220 (3rd Cir. 2000). The court agreed with the ruling of the lower district court and rejected taxpayer’s argument for contractual treatment of the regulatory compact.

Issue 2:

The tangible personal property which the utilities placed in service prior to 1991 did not meet the "specific property requirements" of the ITC transition rule. Case law, as well as legislative history, establishes that the specifications and the amount of the property which

is the subject of the ITC claims must be readily ascertainable from the contract and/or related documents in advance of its purchase. See Zeigler Coal Holding Co., 934 F.Supp. 292 (S.D. Ill. 1996) and Bell Atlantic, supra. The specificity requirement serves to identify specific property that is required to be purchased pursuant to the terms of the contract.

The utilities maintain that their budgets and project estimates are the related documents which identify the property to be placed in service. Budget and project estimates, regardless of their specificity, are inadequate to comply with the ITC transition rules. These documents describe property that may be required. However, there is no legally binding requirement that the property listed in the budget and project estimates must be purchased. Budgets and estimates are mere projections that do not commit the utility to purchase the property with respect to which the ITC is being claimed. The budgets and estimates were maintained not to comply with some contractual arrangement, but as part of good business management to insure that its customers were provided the best service and equipment.

Issue 3:

Finally, regarding the placed in service rules, the government asserts that in order for property with a class life of less than 7 years to qualify as transition property, it must be placed in service prior to 1/1/87. Section 203(b)(2)(C)(ii) states that property described in section 204(a) shall be treated as having a class life of twenty years. Property with a class life of 20 years must be placed in service prior to 1/1/91. However, when these sections are read in conjunction with section 49(e)(1)(C)(ii), property with a class life of less than 7 years cannot be treated as property described in section 204(a) and thus cannot be included as property with a class life of 20 years for purposes of the ITC transition rules. See Kjellstrom, 916 F.Supp. 902 (W.D. Wisc.), aff'd, 100 F.3d 482 (7th Cir. 1996).

INDUSTRY/TAXPAYER POSITION

Issue 1:

The utilities argue that their obligations under franchise agreements and state law qualify as supply or service contracts described in Act section 204(a)(3). They base this argument on the legislative history of Act section 204 and the fact that franchise agreements and statutory obligations imposed on utilities are enforceable contracts under

state law.

The utilities contend that Congress specifically included public utility franchise agreements as an example of an obligation that would qualify as a written supply or service contract. The Conference Report to the Act (H.R. Conf. Rep. No. 99-841 99th Cong., 2d Sess. (1986)) clarifies that written supply or service contracts would include cable television franchise agreements embodied in whole or in part in municipal ordinances or similar enactments before 1986. Conf. Report at II-60. The utilities then argue that a cable television franchise is similar to any other public utility and therefore Congress intended to include any public utility franchise within the definition of a written supply or service contract.

Issue 2:

The property requirement states that property claimed as ITC transition property must be readily identifiable with and necessary to carry out the service contract. Taxpayer argues that the Conference Report elaborates that this requirement is satisfied if the specifications and amount of the property are readily ascertainable from the terms of the contract, or from related documents. Thus, taxpayer argues that the budget projections are related documents and since they enumerate the property type and amounts with great specificity, the property is sufficiently identified with the service contract.

Issue 3:

Finally, regarding the placed in service dates for ITC transition property, taxpayer argues that the statutory language is clear that property described in section 204(a) shall be treated as having a class life of 20 years. Section 203(b)(2)(C)(ii). This argument is aptly supported by Airborne Freight Corp., 96-2 USTC 50,552 (WD Wash. 1996). Therefore, any property placed in service before 1/1/91 qualifies for ITC transition relief.

FACTS

Taxpayers are public utilities that are filing tax claims to recover investment tax credits for property placed in service prior to 1/1/91. Taxpayers argue that this property qualifies as ITC transition property since the property was necessary to operate as a public utility and the property is identifiable in comprehensive budget proposals and engineering documents which are related to its franchise agreements to operate as a utility for the public good.

LAW & ANALYSIS

General Discussion:

Section 204(a)(3) of the Act defines eligible ITC transition property as "property which is readily identifiable with and necessary to carry out a written supply or service contract ... which was binding on [December 31, 1985]."

Regarding the binding contract requirement, there are two colloquies that are relevant. In the first one, Senator Robert Packwood confirmed that a public franchise involving the cable television industry should be treated as a binding contract. "The committee intends that cable television franchises generally do qualify as supply or service contracts for purposes of section 202(d)(3) relating to transition rules." 132 Cong. Rec. S 8252 (daily ed. June 24, 1986). In the second, Senator Packwood stated that "the supply or service contract rule need not be contained solely within the four corners of a single document[,] [further,] ... a series of arrangements which culminate and which make a taxpayer liable for damages if the taxpayer failed to perform under the agreements" meets the requirements of a binding contract. 132 Cong. Rec. S 13953 (daily ed. September 27, 1986).

Regarding the requirement that the property be readily identifiable with the binding contract, there are two relevant pieces of legislative history. First, the Conference Report states that the transitional rule is applicable only where "the specifications and amount of the property are readily ascertainable from the terms of the contract, or from related documents." Conf. Rept. at II-60. Second, a series of colloquies between Senators Matsunaga, Packwood and Long note that "a taxpayer who entered into a written binding power sales contract by the qualification date and is required to construct or have constructed facilities that will produce the power necessary to fulfill this contractual obligation[,]" will satisfy the requirement that the contract identify the property where the contract specified "the type of generating equipment in terms of primary energy source and ... the amount of generating equipment in terms of total generating capacity of the turbines necessary to produce the contracted power[.]" 132 Cong. Rec. S 8241 (daily ed. June 24, 1986).

Thus, it is arguable, based on the above colloquies, that there is no requirement that the service contract identify the amount of property required to be constructed in terms of the precise actual dollar amount of expenditures necessary to construct the property or in terms of the precise property to be acquired.

In Zeigler Coal, supra, the court noted that the property on which ITC was claimed must be readily identified in the coal supply contracts present in that case. The court further noted that the phrase "readily identifiable" was not defined in the statute, however, the Conf. Report explained that the transition rule is applicable only where the specifications and amount of the property are readily ascertainable from the terms of the contract, or from related documents. Conf. Report at II-60. Based on the statute and legislative history, the court ruled that in order for the property claimed by the defendant to be eligible for the ITC under section 204(a)(3), the property must be readily identifiable with the supply contracts, and the specifications and amount of the property must be readily ascertainable from the terms of the contract, or from related documents. This ruling coincides with the position of the government.

The following cases deal with the world headquarters exception to the general repeal of ITC. See Kjellstrom, supra, and Airborne Freight Corp., supra. While not on point factually, there are general principles established in those cases which are useful in deciding the present controversy. First, although the investment tax credit was intended to be construed liberally and included a provision to that effect, the general rule is that transition rules offering tax credits are to be construed strictly in accordance with the intent of Congress. Northwest Steel Rolling Mills, Inc., 40-2 USTC 9755, 311 U.S. 46, 49 (1940); Hemme, 86-1 USTC 13,671, 476 U.S. 558, 566 (1986); Drovers Journal Pub. Co., 43-1 USTC 9411, 135 F.2d 276, 278 (7th Cir. 1943). Secondly, the court in Airborne Freight concluded that, given the plain and unambiguous language of the tax code itself, there was no need to consult the legislative history. Thus, while it is proper to consult the history if there is an ambiguity in the statute, where the statute is clear, the legislative history carries little, if any, evidentiary value.

In a recent District Court decision, Bell Atlantic, supra, the court used the above principles to rule that a “regulatory compact” is not a contract generally and does not qualify as a supply or service contract within the meaning of section 204(a)(3) of the Act. Further, the court ruled that the regulatory compact did not authorize the purchase of particular property and therefore the property on which ITC was claimed by taxpayer was not readily identifiable with and necessary to carry out the regulatory compact within the meaning of section 204(a)(3).

Issue 1:

The question raised is whether the "regulatory compact" consisting of state and federal statutes and local ordinances constituting a franchise and/or tariff agreements and/or certificates of public necessity will meet the definition of a binding contract within the meaning of the ITC transition rules.

Although these franchises are unusual due to the fact that one of the parties is the public at large which is represented by the state regulatory authority or Public Utility Commission (PUC), arguably the essentials of a contract exist. There exists a voluntary, consensual, and reciprocal relationship pursuant to which the PUC offers the utility the right to provide its service in a particular area and the opportunity to earn a reasonable rate of return on its investment, and in exchange the utility agrees to undertake specified service obligations. Nevertheless, it is not likely that a court will find this relationship to constitute a written, binding, supply or service contract within the meaning of section 204(a)(3). See TAM 9649004 and Bell Atlantic, supra.

The utility industry argues that Federal, State and Tax courts have held that a public utility franchise qualifies as a contractual relationship. See Charles River Bridge v. Warren Bridge, 36 US (11 Pet.) 420 (1837); Russell v. Sebastian, 233 US 195 (1914); Delmarva Power & Light Co. v. City of Seaford, 575 A.2d 1089, 1096 (Del. 1990); Board of Fire Comm'rs v. Elizabethtown Water Co., 142 A.2d 85, 87 (NJ 1958); and Jefferson-Pilot Corp., 98 TC 435 (1992), aff'd, 995 F.2d 530 (4th Cir. 1993). In Board of Fire Comm'rs the court held that the "franchise thus created constituted a contract between the utility and the municipality, subject, of course, to the state regulatory power." Also, in Delmarva Power & Light the court stated that "inasmuch as a franchise constitutes a contractual relationship between the sovereign grantor and the public utility grantee, the Commission regulates that relationship on behalf of the grantor." The court in that case takes it for granted that the franchise creates a contractual relationship and thus the franchise operates as a contract.

The government points out that there have been some jurisdictions that have not recognized a utility franchise as granting a contractual relationship. See New Hampshire Public Utilities Commission Order No. 22514, Docket No. DR96-150 175 PUR4th 193 (1997). Note that this is not a state court decision, but rather is an administrative level decision of the New Hampshire Public Utilities Commission. In addition, the court cases cited above to support the taxpayers' position deal with contractual rights in the context of condemnation proceedings rather than the direct issue of whether the franchise is a contract.

The industry further argues that the legislative history supports the notion that a public utility franchise should be treated as a binding contract within the meaning of the ITC transition legislation, as noted in the Senate colloquies cited above, regarding a cable television franchise. However, in that case, it should be noted that a definitive cable television contract may have been involved. Furthermore, the District Court, in Bell Atlantic, supra, has rejected this argument. See the Bell Atlantic decision at page 14, wherein the court stated: "Further, cable television providers are not regulated in the same manner as other

utilities and Congress specifically chose to deal with them separately. See 47 U.S.C. Sec. 541. Therefore, the court finds that Bell Atlantic's reliance on Senator Packwood's statements regarding cable franchises is misplaced in this case concerning telephone service franchises because of their fundamental differences in creation and administration."

Issue 2:

In addition to satisfying the requirement that a written binding contract exists, taxpayer must also establish that the property for which ITC is claimed is "... readily identifiable with and necessary to carry out a written supply or service contract ... which was binding on [December 31, 1985]." Section 204(a)(3) of the Act; I.R.C. sec. 49(e)(1). Thus, the statute sets out two requirements: 1) the property must be identifiable with and 2) necessary to the supply or service contract.

As a general rule, transitional rules should be narrowly interpreted. See United States v. Kjellstrom, 916 F. Supp. 902,905 (W.D. Wis. 1996), aff'd, 100 F. 3d 482 (7th Cir. 1996). Thus, an exception to the general repeal of ITC should only be available to hose taxpayers whose expectations at the time they undertook their obligations would otherwise be defeated by the repeal. See Airborne Freight Corp. v. United States, 153, F. 3d 967 (9th Cir. 1998).

Looking at the first requirement, the statute in section 204(a)(3) requires that the property be readily identified with the service contract. The Conference Report, supra, at II-60 further states that "the transitional rule is applicable only where the specifications and amount of the property are readily ascertainable from the terms of the contract, or from related documents."

Taxpayer reads the above two rules as requiring the identification of the property in either the contract or related documents. These "related documents" have been described as internal documents such as construction design plans, construction contracts, FCC reports, engineering studies and field mapping reports. See PLR 9226006.

However, the government interprets these two rules as involving two distinct requirements. First, the property or its characteristics must be mentioned in the contract itself in a manner sufficient to identify the property with the contract. Second, the specific details relating to the characteristics, dimensions, capacities, dollar amounts, etc., of the property must be stated in the contract and/or related documents. It should be noted that the government's interpretation has been adopted by the district court in Zeigler Coal, supra, wherein the court stated that in order for the property claimed by taxpayer to be eligible for the ITC

under section 204(a)(3), the property must be readily identifiable with the supply contracts, and the specifications and amount of the property must be readily ascertainable from the terms of the contract, or from related documents.

The statute states that the property must be identified with the contract. Thus, the property or its characteristics must be identified sufficiently in the contract to identify it with the contract. This interpretation is alluded to in Senate colloquies regarding a power supply contract. In a colloquy among Senators Matsunaga, Packwood and Long, Senators Packwood and Long confirm that the supply or service contract rule is intended to cover "a taxpayer who entered into a written, binding power sales contract by the qualification date and is required to construct or have constructed facilities that will produce the power necessary to fulfill this contractual obligation." 132 Cong. Rec. S 8241 (daily ed. June 24, 1986). In the same colloquy, Senators Packwood and Long also confirm Senator Matsunaga's understanding that the statutory requirement that the property be readily ascertainable from the terms of the contract is met "when a binding power purchase contract specifies the type of generating equipment in terms of primary energy source and specifies the amount of generating equipment in terms of total generating capacity of the turbines necessary to produce the contracted power[.] In other words, the rule does not require the technical details of the generating property to be spelled out." Id.

The above colloquies establish the requirement that the contract itself (as opposed to "related documents") must identify the property and its characteristics sufficiently to make the property "readily identifiable" with the contract, as required by section 204(a)(3) of the Act. In the colloquy reference, the contract refers to the generating equipment only generally in terms of the necessary energy source and generating capacity. The details regarding the equipment can be contained in the related documents, rather than the contract itself. The point here is that the contract does mention the property generally and in terms of its capacity; and this is sufficient to identify the property with the contract. This is an integral requirement which is statutorily mandated.

The Conf. Report adds that the details concerning the property may be found in the contract or the related documents. This is logical since it cannot be expected that all the voluminous details concerning specific property should be required to be enumerated in the contract itself. However, these details would be contained in related documents to the contract.

Taxpayers have also argued that supply contracts entered into prior to December 31, 1985, should be deemed to implicitly require all property acquired after December 31, 1985, and thus be entitled to ITC. This position has not been adopted by the Tax Court or by the two federal district courts that have considered the issue, as noted below. In Zeigler Coal, supra, the court rejected taxpayer's argument in favor of a broad reading of the transition rule, stating that "... to allow a supply contract to implicitly require the acquisition

of property means that the transition rule exception would swallow the rule for eliminating ITC." Id. at 295. See also Bell Atlantic, supra, and Southern Multi-Media Communications Inc., et al. v. Commissioner; 113 T.C. 412 (1999).

In Bell Atlantic, the court held that, in order to satisfy the supply contract rule, the property must be specifically described by the terms of the contract, or from related documents that evidence a binding commitment to acquire the property specified. Id. at 21-23. The court rejected the notion that the specific property could be inferred from the contract and related documents. Significantly, the court also rejected Bell Atlantic's claims that the "readily identifiable" requirement was satisfied by reference to non-binding internal budget and project estimates, or reports generated specifically for litigation. Id. at 21. Instead, the court concluded that such documents were merely internal business management tools rather than related to the formation or execution of a binding written contract. Id.

With regard to the second requirement, the "necessary to carry out" element, the Bell Atlantic court determined that the property must be "essential" or "logically inevitable" or "absolutely required" in connection to the underlying service or supply contract. Id. at 21-22. According to the court, to be considered "necessary to carry out" the underlying contract, property must be subject to binding provisions in reference to the other party to the contract; otherwise the link is too attenuated. Id. at 23. Necessity does not exist when purported related documents are unilateral internal documents prepared for business purposes by the taxpayer. Id. at 22.

In Southern Multi-Media Communications Inc., supra, a recently decided case involving a cable television franchise, the court noted that under the taxpayer's reasoning, "... all improvements to its systems arguably would be readily identifiable with and necessary to carry out the broad franchise agreements that were in effect as of December 31, 1985." The court further stated: "As we read the supply or service transition rule, however, the plain meaning of the statute does not permit this interpretation. Congress granted only limited, transition relief to businesses that, as of December 31, 1985, had binding commitments to undertake specific investments in qualified property. See Bell Atl. Corp. v. United States, 82 AFTR 2d at 98-7378, 99-1 USTC at 87,036; H. Conf. Rept. 99-841 (Vol. II), 1986-3 C.B. (Vol. 4) 60. Much like the franchise agreements involved in Bell Atl. Corp. v. United States, supra, the general language of Wometco's franchise agreements, without more, reflects only broad industry standards, not specific contractual commitments to undertake rebuilds." See also Commonwealth Energy v. United States, 235 F.3d 11 (1st Cir. 2000), wherein the court ruled that property on which ITC was claimed was not "readily identifiable with" and necessary for the 1965 power supply contract in which taxpayer agreed to construct a power plant. Further, the court stated that "requiring that the property be readily identifiable at the time the contract is enacted makes it more likely that the company claiming investment tax credit relied to its detriment on the credit." 235 F. 3d at 18.

Issue 3:

This issue deals with the placed in service requirements for ITC transition property.

Section 49(e) addresses the placed in service dates for ITC transition property. Section 49(e)(1)(C)(i) provides that in the case of transition property with a class life of less than 7 years, section 203(b)(2) of the Act shall apply. Section 49(e)(1)(C)(ii) provides that in the case of property with a class life of less than 5 years, the placed in service date is July 1, 1986, and in the case of property with a class life of at least 5 years, but less than 7 years, the placed in service date is January 1, 1987.

Section 203(b)(2)(A) of the Act provides that section 204(a) shall not apply to any property unless the property has a class life of at least 7 years and is placed in service before January 1, 1989, in the case of property with a class life of at least 7 but less than 20 years, or placed in service before January 1, 1991, in the case of property with a class life of 20 years or more. Section 203(b)(2)(C) of the Act provides that for purposes of section 203(b)(2)(A), property described in section 204(a) shall be treated as having a class life of 20 years.

With the above statutory provisions in mind, the courts have interpreted the placed in service dates for transition property inconsistently. Although the District court sided with the taxpayer in Airborne Freight, supra, the appellate court for the 9th Circuit has recently reversed this holding and held for the government in Airborne Freight Corporation, No. 97-35129 (9th Cir., August 20, 1998). (Hereinafter the appellate court case will be referred to as Airborne while the District court decision will be referred to as Airborne Freight.)

The holdings of Kjellstrom, supra and Airborne, supra are consistent regarding property with a class life of 7 years or greater. These courts held that such property has a placed in service date of January 1, 1991. However, regarding property with a class life of less than 7 years, the holdings are not in agreement. Kjellstrom held that property with a class life of less than 5 years has a placed in service date of July 1, 1986 and property with a class life of at least 5 years but less than 7 years has a placed in service date of January 1, 1987. Airborne held that all property with a class life of less than 7 years is not eligible for transition relief from the ITC repeal found in section 204(a) of the Act.

SETTLEMENT GUIDELINES

Issue 1

Considering the above legislative history and case law, while it is possible for a court to rule that a contractual relationship is created from the utility franchise, tariff or other agreement, it is not likely and it is even more unlikely that a court would find the regulatory compact qualifies as a binding supply or service contract. Thus, even assuming, arguendo, that the regulatory compact qualifies as a contract under the ordinary meaning of that term, it is not likely a binding supply or service contract under the ITC transition rules. The agreements comprising the regulatory compact are generally voluntary and terminable at will. Further, they do not require the utility to provide any services or install any property, but rather only to satisfy certain general standards regarding the services that the utilities do provide.

In conclusion, in the situation where the taxpayer is relying on the "regulatory compact" to imply a contract and claim ITC, the taxpayer's case is weak. However, it should be noted that where the taxpayer has an actual supply or service contract which states specific service requirements and property to be purchased, this settlement guideline is not applicable. In that case, the litigating hazards must be considered anew to determine if the statutory requirements are met.

Based on the above analysis, the hazards to taxpayer on this issue are excessive and the issue should be conceded by the taxpayer. Note that this opinion relies heavily on the District Court decision in Bell Atlantic, supra, which rejected taxpayer's position on all counts. If subsequent litigation changes this result, the hazards will change accordingly.

Issue 2

Taxpayer's interpretation noted above ignores the statutory requirement that the contract itself identify the property. Taxpayer argues, in effect, that the conference report would replace the statutory requirement, so that either the contract or related documents may identify the property. However, the statutory requirement cannot be modified by the conference report. Rather, the more sound interpretation is that the conference report is a clarification of the statutory requirement to allow the details and specifications of the property to be contained in "related documents" rather than the contract itself.

Even assuming, arguendo, that the contract or the related documents may satisfy the

property identification requirement, neither the regulatory compact or the related documents identify the property to the contract or show that it is necessary. The regulatory compact does describe general service requirements but no specific property is required to be purchased. Further, the related documents often describe specific property but the related documents do not identify that property to the regulatory compact or other specific contract. Thus, the requirement in section 204(a)(3) that the property claimed be "readily identifiable with and necessary to carry out" a specific contract is not met. This conclusion is amply supported by the Zeigler Coal, Bell Atlantic, and Southern Multi-Media decisions noted above.

The court, in the Bell Atlantic decision, at pages 21 and 22, addressed this issue and stated that "...the proffered related documents were generated for internal forecasting rather than for the alleged contracts. The internal documents were not related to the contracts or prepared contemporaneously with the contract in many cases. Moreover, these documents were not provided to the other contracting parties and do not evidence a commitment; they are merely internal business management tools rather than related to the formation or execution of a particular contract." The court then concluded that to adopt taxpayer's position would allow every utility to claim ITC for virtually all of its routine business expenditures. Such a result is wholly inconsistent with the purpose of the statute since the exception would wash away the rule.

Therefore, in order for property to be treated as ITC transition property, the binding written contract from which a taxpayer derives its authority to purchase the property must mention the property or its characteristics sufficiently that it may be identified with the contract. Further, the details as to specifications and dollar amounts must be provided in the contract or related documents.

In keeping with the above discussion, taxpayer should provide evidence of the specific contracts that are relied upon as authority for the ITC property acquired. In addition, these contracts should identify the property, as noted above, and the related documents should verify the specifics regarding such property. This evidence should be examined carefully by Appeals to insure that the statutory requirements of Section 204(a)(3) of the Act are met. If the contracts do not mention any specific property or property characteristics sufficiently to identify the property with the contract, no ITC transitional relief can be granted.

Issue 3

The court in Airborne pointed out that the statute was very poorly drafted and this was the reason for so much confusion among the court cases ruling on this issue. With this reasoning in mind and the inconsistencies between Kjellstrom and the Airborne courts,

there are hazards to both parties on this issue. However, since the latest appellate decision favors the government position, the hazards of litigation will clearly favor the government on this issue.

Therefore, regarding property with a class life of 7 years or greater, a placed in service date of January 1, 1991 will result. However, for property with a class life of less than 7 years, it is very likely that the property will either have a placed in service date of no later than January 1, 1987, or simply be ineligible for ITC altogether. The practical effect of these court decisions is to render only property with a class life of 7 years or greater eligible for ITC transition relief, but only if issues 1 & 2 above are favorable to the taxpayer, which is unlikely to occur.

CONCLUSION

Considering the hazards of litigation as to each of the 3 issues presented above, and the fact that taxpayer must be successful on all 3 issues to prevail, the overall hazards to taxpayer are excessive and taxpayer should fully concede the ITC claims.

Finally, it should be noted that many of these claims are based on estimates and are not fully developed factually prior to arriving in Appeals. Therefore, the appeals officer should initially insure that the amounts claimed are actual amounts and have been fully verified. For instance, taxpayer should be able to verify the specific contract and the contract should make mention of the property on which the ITC claim is based. Further, the property should be specifically described in the contract and/or related documents, including the amounts of the property. Further, the amounts expended on the property should be verified with reliable source documents. Undeveloped cases, including claims based on estimates, may have to be returned to Examination for further development or disallowed based on lack of verification.