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How The New Tax Law Bluebook Impacts Regulated Utilities

By **David Burton and Anne Levin-Nussbaum**
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David Burton

Anne Levin-Nussbaum

The recently released Joint Committee on Taxation's Bluebook explanation[1] of the Tax Cuts and Jobs Act[2] confirms that qualifying tangible property leased to a regulated public utility is eligible for the new 100 percent expensing rules, also called full expensing,[3] even if the property would not be eligible for full expensing if it were owned by the regulated utility.

As discussed below, there was some concern in the industry that an exception applicable to certain property used by a regulated utility, or the regulated utility exception,[4] might extend to an owner/lessor leasing to a regulated utility. With the release of the Bluebook, we would expect there to be more lessors prepared to offer advantageous lease financing rates to regulated utilities, reflecting the lessor's ability to claim full expensing.

For property to be eligible for full expensing it must satisfy the requirements to be considered "qualified property" under Internal Revenue Code Section 168(k)(2),[5] which, inter alia, requires that the property must be new to the taxpayer — although it can be used property — and placed in service after Sept. 27, 2017, and before Jan. 1, 2023.[6] Qualified property placed in service beginning Jan. 1, 2023, and before Jan, 1, 2027, remains eligible for first-year "bonus depreciation;" but the rate phases down 20 percent each calendar year.[7]

The regulated utility exception provides that property primarily used in a trade or business described in clause (iv) of Section 163(j)(7)(A) is not considered qualified property. Section 163(j)(7)(A) lists trades or businesses that are not subject to the limitations on interest deductions imposed under Section 163(j) — each, an "excluded business." Clause (iv) describes the trade or business of a regulated utility, an "excluded regulated utility business".[8] In other words, interest allocated to an excluded regulated utility business is deductible without regard to the TCJA's new Section 163(j) annual limitations, a significant tax benefit. The trade-off is that property primarily used in an excluded regulated utility business is not eligible for full expensing.

Our view — confirmed by the Bluebook — has been that the regulated utility exception only applies to property owned by a regulated utility — as opposed to property owned by another taxpayer but used by a regulated utility under a lease.[9] Accordingly, an owner/lessor that leases property to a regulated utility could claim full expensing — even though the regulated utility itself could not.

There are several reasons for our view. First, we consider the language in Section 168(k)(9) to be clear in indicating that the exception only applies to property used in a trade or business that gets the benefit of the exclusion from the Section 163(j) interest limitations. This would not be the case for an owner/lessor, whose use of the property is in a leasing trade or business. Given the apparent trade-off of full expensing for interest deductions, there does not appear to be any policy reason for denying full expensing to the owner/lessor.

The regulated utility exception is different from the rules that apply to tax-exempt use property, which preclude a lessor from claiming full expensing on property leased to a tax-exempt entity.[10] For such property, the statute references depreciation provisions that expressly apply to property "leased" by the taxpayer to a tax-exempt entity.[11] In contrast, there is nothing in Section 168(k)(9), elsewhere in the TCJA or the legislative history that refers to property leased to a regulated utility or that suggests that use in an excluded regulated utility business means anything other than use by the taxpayer with the depreciable interest in the property.

There are U.S. Department of the Treasury regulations under Sections 46 and 167 that include provisions whereby leased property could be characterized as "public utility property" based on the status or activities of a lessee of leased property.[12] But, neither of these Treasury regulations is directly applicable to the full expensing rules enacted under the TCJA. The Treasury regulation under Section 46 relates to an investment tax credit statute, not a depreciation statute. Further, what constitutes "public utility property" involves an entirely different type of analysis and different considerations under both of these Treasury regulations than the determination of what constitutes property used in an excluded regulated utility business.[13]

It is also worth noting that Congress does not use the term "public utility property" to define property that is excluded from full expensing. The term "public utility property" is defined in Section 168(i)(10) to mean property primarily used in the trade or business of a regulated utility, with the meaning of regulated utility being essentially the same as the trade or business of a regulated utility, as described in Section 163(j)(7)(A)(iv), subject to some small modifications.[14] There is one significant difference: Property subject to the exception from full expensing is only property used in a regulated utility trade or business if that trade or business is excepted from the interest limitations under Section 163(j) — i.e., the trade-off is essential. This further supports the position that Congress did not intend for these other definitions or approaches to apply in the case of the regulated utility exception.

Nonetheless, given the approach taken in the two Treasury regulations, there were some lessors who wanted explicit confirmation that they would not be precluded from claiming full expensing with respect to qualified property leased to a regulated utility. The Bluebook provides that confirmation.

In a footnote explaining the regulated utility exception, the Bluebook states:

> It is intended that the [regulated utility Exception] only apply to regulated public utility or electric cooperative trades or businesses excluded from the interest limitation under section 163(j)(7)(A)(iv). For example, property leased by a leasing trade or business to a regulated public utility would not be precluded by section 168(k)(9)(A) from claiming [full expensing] on its qualified property because the leasing trade or business is not excluded from the interest limitation by section 163(j)(7)(a)(iv).[15]

In a corollary footnote to the discussion of Section 163(j), the Bluebook notes that interest deductions allocable to the trades or businesses of regulated utilities are not considered business interest and, therefore, are not subject to the interest deduction limitation. The footnote goes on to expressly tie the benefit of being an excluded business to the quid pro quo of losing full expensing, stating:

> any property primarily used by a regulated public utility trade or business with a depreciable interest in the property is not eligible for the additional first-year depreciation deduction by such utility business under section 168(k), as modified by the Act.[16]

Describing the regulated utility exception as applying where the regulated utility has a "depreciable interest" in the property further supports the view that the regulated utility exception only applies to property owned by a regulated utility, not property leased to it.

We believe these footnotes should be sufficient to dispel any uncertainty about whether full expensing would be available for property leased to a regulated utility. Bluebooks technically are not legislative history because they are prepared after legislation has been enacted.[17] Nonetheless, given the strong support in the legislation itself — discussed above, as confirmed by the explanations in the Bluebook, it seems unlikely that the Internal Revenue Service would take a contrary view.

We expect this confirmation that Section 168(j)(9) applies only to property owned by a regulated utility to be welcome news to the leasing and utility industries. As lessors now have comfort that full expensing will be available with respect qualified property leased to regulated utilities, we expect there to be advantageous leasing financing options available to regulated utilities.

David Burton is a partner and Anne Levin-Nussbaum is counsel at Mayer Brown LLP.

[1] Staff of Joint Comm. on Taxation, 115th Cong., 2d Sess., General Explanation of Public Law 115-97 (JCS-1 2018) (the "Bluebook").

[2] The Tax Cuts and Jobs Act, H.R. 1, 115th Cong., 2d Sess. (2017).

[3] See Bluebook at 126 n. 551.

[4] IRC Section 168(k)(9)(A). The specifics of the Regulated Utility Exception are described below.

[5] Unless otherwise stated, all Section references are to the Internal Revenue Code of 1986, as amended.

[6] IRC Section 168(k)(6)(A)(i). There is an extended deadline for certain long-production property and aircraft. Section 168(k)(2)(B).

[7] IRC Section 168(k)(6)(A)(ii) – (v). In other words, for property placed in service on or after Jan. 1, 2023, the additional first-year deduction is 80 percent in 2023, 60 percent in 2024, and so on until a final phase out beginning Jan. 1, 2027. The dates are extended by one year for certain long-production period property. IRC Section 168(k)(6)(B).

[8]

> The trade or business of a regulated utility is described as being the furnishing or sale of:
>
> (I) — electrical energy, water, or sewage disposal services,
>
> (II) —gas or steam through a local distribution system, or
>
> (III) — transportation of gas or steam by pipeline,
>
> if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, by a public service or public utility commission or other similar body of any State or political subdivision thereof, or by the governing or ratemaking body of an electric cooperative.

IRC Section 163(j)(7)(A)(iv).

[9] David Burton and Anne Levin-Nussbaum, "The Impact of Tax Reform: What Equipment Leasing Companies Need to Know," (Feb. 7, 2018) https://www.taxequitytimes.com/wp-content/uploads/sites/15/2018/02/TaxReform_Article-for-ELFA_02162018.pdf.

[10] IRC Section 168(k)(2)(D), -(g)(1)(B), -(h).

[11] IRC Section 168(h).

[12] See Treas. Reg. Section 1.46-3(g)(3) (property leased by a non-utility lessor to a utility is subject to the same restrictions in the lessor's hands as in the utility's hands); Treas. Reg. Section 1.167(l)-3(b)(1) (property leased by a non-utility lessor to a to a utility is considered public utility property, but not subject to the same restrictions in the lessor's hands as in the utility's hands).

[13] See Treas. Reg. Section 1.46-3(g)(1), -(2), -(3); Treas. Reg. Section 1.167(l)-1(b).

[14] A comparison of Section 168(i)(10) and Section 163(j)(7)(A)(iv) reveals that the only differences are (i) clause (C) — addressing telecommunication monopolies which no longer exist — and (ii) the addition of the reference in the reference in Section 163(j)(7)(A)(iv) to "or by the governing or ratemaking body of an electric cooperative."

Section 168(i)(10) provides:

> The term "public utility property" means property used predominantly in the trade or business of the furnishing or sale of—
>
> (A) electrical energy, water, or sewage disposal services,
>
> (B) gas or steam through a local distribution system,
>
> (C) telephone services, or other communication services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. 701), or
>
> (D) transportation of gas or steam by pipeline,
>
> if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

Section 163(j)(7)(A)(iv) describes:

> the trade or business of the furnishing or sale of—
>
> (I) electrical energy, water, or sewage disposal services,
>
> (II) gas or steam through a local distribution system, or
>
> (III) transportation of gas or steam by pipeline,
>
> if the rates for such furnishing or sale, as the case may be, have been established or approved by

> a State or political subdivision thereof, by any agency or instrumentality of the United States, by a public service or public utility commission or other similar body of any State or political subdivision thereof, or by the governing or ratemaking body of an electric cooperative.

[15] Bluebook at 126 n. 551.

[16] Bluebook at 179 n. 888.

[17] See United States v. Woods, 571 U.S. 31, 47-48 (2013) (JCT staff explanations are "commentaries" on the legislation and were not considered by members of Congress in voting for the legislation; but, like law review articles, may be relevant to the extent persuasive).