

Transmission Provider for the installation of Transmission Provider's Interconnection Facilities and Network Upgrades are non-taxable, either as contributions to capital, or as advances.

Comments

424. Peabody endorses this proposed provision. It argues that it is in the best interest of Interconnection Customers, Transmission Providers and customers to take advantage of the tax exemption for payments that Interconnection Customers make to Transmission Providers for Network Upgrades made pursuant to an LGIA.

425. Progress Energy argues that an Interconnection Customer's right to terminate the LGIA on 30 Calendar Days' written notice may jeopardize the safe harbor treatment of Interconnection Customer contributions because the IRS safe harbor provisions apply only to interconnection agreements with a minimum term of ten years.

Commission Conclusion

426. In response to Progress Energy, the mere existence of the 30 day termination provision does not mean that the Interconnection Agreement conflicts with the IRS minimum term requirement of ten years. Nevertheless, if either Party in fact terminates the LGIA before ten years have passed, the IRS may then conclude that the Interconnection Customer's payments are indeed taxable. Accordingly, the Parties should consider these possible tax consequences when deciding whether to terminate an LGIA within ten years.

427. This article is designated Article 5.17.1 in the Final Rule LGIA.

428. *Article 5.14.2—Representations and Covenants* (In the Final Rule LGIA: Article 5.17.2)—Proposed LGIA Article 5.14.2 set forth the representations and covenants that would be agreed to by the Parties to conform to the requirements of the IRS safe harbor provisions set forth in the relevant IRS Notices.

Comments

429. FirstEnergy argues that in order for the Interconnection Customer's payments to the Transmission Provider to be deemed non-taxable under the IRS safe harbor provisions, ownership of the electricity generated at the Generating Facility must pass to another entity prior to the transmission of the electricity on the Transmission System. FirstEnergy asks the Commission to clarify the representations and proposed covenants in proposed LGIA Article 5.14.2 to refer to the Point of

Interconnection or Point of Change of Ownership.

Commission Conclusion

430. We do not intend to interpret the IRS safe harbor provisions, and so we leave it to the Parties to ensure that their conduct, including the point at which the ownership of electric energy produced by the Generating Facility changes hands, conform to IRS policy.

431. This article is designated Article 5.17.2 in the Final Rule LGIA.

432. *Article 5.14.3—Indemnification for Taxes Imposed Upon Transmission Provider*—Proposed LGIA Article 5.14.3 would have required that the Interconnection Customer indemnify (hold harmless) the Transmission Provider from income taxes imposed against the Transmission Provider as a result of payments or property transfers made by Interconnection Customer to the Transmission Provider under the LGIA—that is, if the IRS safe harbor provisions do not keep the Transmission Provider from having to pay income taxes. The Transmission Provider would not include a gross-up⁷⁷ for income taxes unless either it has made a good faith determination that the payment or transfers should be recorded as income subject to taxation, or any Governmental Authority directs Transmission Provider to treat the payment or transfers as subject to taxation. As an alternative to the gross-up, the Transmission Provider would be able to require the Interconnection Customer to provide security in a form reasonably acceptable to the Transmission Provider and in an amount equal to the Interconnection Customer's estimated tax liability.

Comments

433. MidAmerican supports Article 5.14.3 and recommends that the Transmission Owner be added to this provision by changing Transmission Provider to Transmission Provider or Transmission Owner.

434. LADWP argues that although Section 5 of the Commission's OATT provides that the transmission customer must indemnify the Transmission Provider that owns facilities financed by tax-exempt debt, it is not clear whether that provision would apply to an Interconnection Customer. LADWP asks the Commission to clarify that an Interconnection Customer is liable for the cost of any adverse tax consequences visited on the public

power Transmission Owner because of the interconnection.

435. SoCal PPA believes that the Interconnection Customer's obligation to reimburse the Transmission Provider for taxes should cover *ad valorem* property taxes and other taxes assessed against the Transmission Provider.

436. NE Utilities seeks an alternative method for a Transmission Provider to recover tax liability for which it is not reimbursed due to circumstances beyond its control—for example, if the security instrument provided by the Interconnection Customer does not cover the full tax liability or if the Interconnection Customer defaults on its obligation to indemnify the Transmission Provider. It argues that in these situations, the Commission should authorize the Transmission Provider to recover the remaining balance from customers.

437. TXU says that the Commission should provide comprehensive protection for a Transmission Provider if the IRS decides that Interconnection Customer payments are taxable. A letter of credit, as provided for in proposed LGIA Article 5.14.3, would provide some security for the Transmission Provider, but may limit the process of contesting IRS positions and may prove otherwise difficult to administer. Without elaborating, TXU requests that a more comprehensive security device be required until definitive guidance is received from the IRS.

438. SoCal Edison states that if a Transmission Provider or Transmission Owner is unable to recover from a generator any income tax incurred as a result of an interconnection arrangement, the Commission should provide Transmission Providers and Transmission Owners with a regulatory backstop that would guarantee the recovery of these income taxes in transmission rates. It adds that to the extent that a Transmission Provider or Transmission Owner is unable to include income taxes in transmission rates because of other regulatory restrictions (such as a rate freeze or the requirement to have state commission approval for such rates), the Transmission Provider or Transmission Owner should have discretion in determining the appropriate form and level of security required from the generator at the time the IA becomes effective, and a right to offset any tax liability against any transmission credit owed. Further, SoCal Edison says Article 5.14 must state that any future payment shall include interest and penalties, as well as any other costs imposed by the IRS.

⁷⁷ A gross-up for income taxes is a dollar amount calculated to determine the Interconnection Customer's estimated tax liability to the Transmission Owner.