

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-02(22)C
Corporation Tax
December 18, 2002

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C020531A

On May 31, 2002, a Petition for Advisory Opinion was received from Central Hudson Gas & Electric Corp., 284 South Avenue, Poughkeepsie, New York 12601.

The issue raised by Petitioner, Central Hudson Gas & Electric Corp., is whether the distribution of Petitioner's fossil and nuclear electric generating plant assets to unaffiliated parties pursuant to auction processes mandated by the Public Service Commission (PSC) is considered as one transaction or sale for purposes of determining gross income under section 186-a of the Tax Law, with the profit determined on the basis of the aggregate of all of the assets.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Petitioner is a combination gas and electric utility engaged principally in the generation, transmission, distribution and sale of electric energy and the sale, transportation and distribution of natural gas in the Hudson River Valley area of New York. Petitioner's wholesale rates and services are regulated by the Federal Energy Regulatory Commission (FERC) and its retail rates and services are regulated by the PSC.

In 2001, Petitioner sold its interests in fossil and nuclear (Nine Mile Point 2) generation facilities to unaffiliated buyers in auction processes conducted in response to requirements of the PSC arising out of the Competitive Opportunities Proceeding instituted in 1994 by the PSC in Case No. 94-E-0952 which endorsed a fundamental restructuring of the electric utility industry in New York State based on competition in the generation and energy services sectors of that industry. In its Opinion and Order Regarding Competitive Opportunities for Electric Service, Opinion No. 96-12 (Issued and Effective May 20, 1996), the PSC stated that it "... strongly encourage[d] divestiture, particularly of generation assets...." (Slip Op. at 60).

In August, 1997, in its Competitive Opportunities Proceeding, the PSC had issued for public comment a Staff Report on Nuclear Generation ("Staff Nuclear Report"), in which, as a preferred statewide nuclear solution, the PSC's Staff recommended that nuclear power plants be sold to third parties, preferably through an auction process. On the same day that it issued its Opinion and Order in Case Nos. 94-E-0098 and 94-E-0099, and following receipt of comments from the public on the Staff Nuclear Report, the PSC adopted "as a rebuttable presumption the premise that nuclear power should be priced on a market basis to the same degree as power from other sources." The PSC also transferred its consideration of the sales of nuclear units from its Competitive Opportunities Proceeding to a generic proceeding (PSC Case No. 98-E-0405, Proceeding Concerning Nuclear Generation in a Competitive Electric Market). PSC Opinion No. 98-7, Case 94-E-0921 and

98-E-0405, Opinion and Order Instituting Further Inquiry (Issued and Effective March 20, 1998), at 44.

In July, 1999, while the generic nuclear proceeding was pending, two of the co-owners of Nine Mile Point 2 announced a proposal to sell their ownership interests to an unaffiliated third party. That proposed sale was the product of a negotiated agreement among the parties, not an auction process. The transaction was subject to PSC approval pursuant to section 70 of the Public Service Law, and the PSC instituted a proceeding to consider the proposed sale. A number of parties, including Petitioner, intervened in the proceeding and opposed the transaction on various grounds. After significant discovery, one of the sellers formally requested that the PSC dismiss its petition for approval of the sale. In considering that request, the PSC stated that it was appropriate that the owners of Nine Mile Point 2 explore promptly, through an auction sale process, the market value of Nine Mile Point 2. The PSC stated that “(1) the separation of generation from transmission and distribution advances the Commission’s long-standing policy of supporting competition in the wholesale generation market; (2) the sale by utilities of their generating facilities at current market values would constitute appropriate mitigation of their stranded costs and would establish a basis for the Commission to further consider the extent of the utilities’ ability to recover their remaining stranded costs; and (3) the Commission would resolve the ratemaking treatment of any sale of the Nine Mile facilities by following the principles established in the utilities’ competitive opportunities/restructuring orders and examining reduced utility risks and corollary effects resulting from plant divestiture.” Case No. 99-E-0933, Order Allowing Petitions to be Withdrawn, Slip Opinion at 7.

As a result, Petitioner and other co-owners began an auction process that led to the sale of Petitioner’s (and other co-owners’) interests in Nine Mile Point 2 to a third party unaffiliated with any of the sellers. The auction process entailed the active involvement of PSC Staff members. The PSC approved the transaction in October, 2001. Case No. 01-E-0011, Order Authorizing Asset Transfers (Issued and Effective October 26, 2001.)

The fossil generating plant asset sales were also implemented through auction processes that were reviewed by the PSC and/or participated in by the PSC’s staff, and the sales of the assets to the successful bidders in the auction processes were approved by the PSC. See Central Hudson Gas & Electric Corporation, Adv Op Comm T&F, July 29, 1998, TSB-A-98(12)C, relating to the corporate restructuring of Petitioner into a holding company and the sale of Petitioner’s fossil fueled electric generating plant assets.

Applicable Law

Section 186-a.2(c) of the Tax Law provides, in part:

the words “gross income” mean and include receipts received in or by reason of any sale, conditional or otherwise, (except sales hereinafter referred to with

respect to which it is provided that profits from the sale shall be included in gross income) made or service rendered for ultimate consumption or use by the purchaser in this state

* * *

(5) "Gross income" also includes profits from the sale of securities; also profits from the sale of real property growing out of the ownership or use of or interest in such property; also profit from the sale of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the period for which a return is made); also receipts from interest, dividends, and royalties, derived from sources within this state other than such as are received from a corporation a majority of whose voting stock is owned by the taxpaying utility, without any deduction therefrom for any expenses whatsoever incurred in connection with the receipt thereof, also profits from any transaction (except sales for resale and rentals) within this state whatsoever;

Opinion

In Central Hudson, supra, in the Answer to Question 11, asking "If ... Petitioner ... were to sell the CH Generation Assets to an unaffiliated party pursuant to the Auction Process, would any portion of the value of the consideration received by Petitioner ... be considered as ... "gross income" under section 186-a of the Tax Law?", the Advisory Opinion held, that

the sale of the CH Generation Assets by Petitioner ... to an unaffiliated party pursuant to the Auction Process is part of a series of transactions being entered into by Petitioner as mandated by the PSC pursuant to the Competitive Opportunities Proceeding and the PSC's policy objectives set forth in the Order (Opinion No. 96-12), and implemented under the restructuring plan described in the Restated Settlement Agreement dated January 2, 1998, as modified February 26, 1998, which includes the structural separation of the CH Generation Assets and the sale of the assets at Auction.

* * *

With respect to the tax imposed under section 186-a of the Tax Law, Petitioner ... will realize "gross income" to the extent that a profit is generated from the sale of the CH Generation Assets, by ... Petitioner ... to an unaffiliated party pursuant to the Auction Process. Following LILCO-I [Long Island Lighting Company], Adv Op Comm T&F, May 19, 1995, TSB-A-95(9)C], the profit, if any, would equal the amount that the consideration received by Petitioner ... as a result of the Auction Process exceeds the original cost of the CH Generation Assets,

without deduction for depreciation, except that, with respect to Petitioner's Roseton Plant Interest that is treated as a partnership interest, "original cost" means the amount of Petitioner's original contribution establishing its ownership interest in the Roseton Plant plus any additional contributions that Petitioner made. Expenses of the sale are allowed to be deducted. It is appropriate in this situation to consider the distribution of the assets as one transaction or sale. Accordingly, the profit would be determined based on the sale of the aggregate of all the assets, not the sale of each asset separately. If the sale of the CH Generation Assets results in a loss, rather than a profit, such loss may not be deducted from Petitioner's ... other gross income.

In Niagara Mohawk Power Corporation, Adv Op Comm T&F, January 27, 1999, TSB-A-99(9)C, it was concluded, in part, that

following LILCO-I, supra, and Central Hudson, supra, the profit from the divestiture of the [fossil and hydro-electric generating] Facilities via auction that constitutes gross income under section 186-a of the Tax Law would equal the amount that the consideration received by Petitioner as a result of the auction process exceeds the original cost of the Facilities, without deduction for depreciation. Expenses of the sale are allowed to be deducted. It is appropriate in this situation to consider the divestiture of the Facilities as one transaction or sale. Accordingly, the profit for the taxable year would be determined based on the sale of the aggregate of the Facilities during the taxable year, not the sale of each generating facility separately. If the sale of the Facilities results in a loss, rather than a profit, such loss may not be deducted from Petitioner's other gross income.

In this case, the sale of Petitioner's interest in the fossil generating assets through the auction process was pursuant to the modified Restated Settlement Agreement, and consisted of the CH Generation Assets, as described in Central Hudson, supra. Pursuant to such Advisory Opinion, the sale of Petitioner's interest in such fossil generating assets is treated as one transaction or sale, and Petitioner will realize "gross income", under section 186-a of the Tax Law, to the extent that a profit is generated from such sale. Following Central Hudson, supra, the profit, if any, would equal the amount that the consideration received by Petitioner as a result of the Auction Process exceeds the original cost of the fossil generating assets, without deduction for depreciation. However, Central Hudson, supra, concluded that with respect to Petitioner's Roseton Plant Interest that is treated as a partnership interest, "original cost" means the amount of Petitioner's original contribution establishing its ownership interest in the Roseton Plant plus any additional contributions that Petitioner made. Expenses of the sale are allowed to be deducted.

The sale of Petitioner's interest in the nuclear generating assets of Nine Mile Point 2 through the auction process was in response to PSC Opinion No. 98-7 and PSC Case No. 99-E-0933, and was approved in PSC Case No. 01-E-0011. Like the sale of the fossil generating assets through the auction process, it is appropriate to treat the sale of the nuclear generating assets of Nine Mile

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Point 2 as one transaction or sale, and Petitioner will realize “gross income”, under section 186-a of the Tax Law, to the extent a profit is generated from such sale. Likewise, following Central Hudson, supra, the profit, if any, would equal the amount that the consideration received by Petitioner as a result of the auction exceeds the original cost of the nuclear generating assets, without deduction for depreciation. In this case, “original cost” means the amount of Petitioner’s original contribution establishing its ownership interest in Nine Mile Point 2 plus any additional contributions that Petitioner made. Expenses of the sale are allowed to be deducted.

Further, following Niagara Mohawk, supra, Petitioner’s profit, if any, that is recognized as gross income under section 186-a of the Tax Law, is determined based on the sale of the aggregate of Petitioner’s interests in the fossil generating assets at auction and the nuclear generating assets of Nine Mile Point 2 at auction during the taxable year, not the sale of fossil generating assets and nuclear generating assets separately. If the sale of the aggregate of Petitioner’s interests in the fossil generating assets and the nuclear generating assets during the taxable year results in a loss, rather than a profit, such loss may not be deducted from Petitioner’s other gross income.

DATED: December 18, 2002

/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.