

**CPUC RULEMAKING 17-07-007**

**RULEMAKING TO CONSIDER STREAMLINING INTERCONNECTION OF  
DISTRIBUTED ENERGY RESOURCES AND IMPROVEMENTS TO RULE 21**

**ADDRESSING ISSUE #7 OF 10/2/2017 SCOPING MEMO –APPLICATIONS OF ITCC  
BY PG&E, SDG&E AND SCE IN RULE 21 TRANSACTIONS**

**Purpose**

- On July 21, 2017, the CPUC issued Order Instituting Rulemaking 17-07-007 (“R17-07-007”) “to consider a variety of refinements to the interconnection of distributed energy resources under Electric Tariff Rule 21.” Comments to R17-07-007 were filed by August 2, 2017, and reply comments were filed by August 14, 2017.
- On October 2, 2017, the assigned commissioner and ALJ issued the related Scoping Memo for R17-07-007.
- Issue #7 of the Scoping Memo asked the following questions - *“Is there inconsistent application of the requirement to pay the Income Tax Component of Contribution (“ITCC”) charges across the Utilities? If yes, how should the Commission address this inconsistency?”*
  - The genesis of Issue #7 was from the following Clean Coalition comment:

*“ITCC and inconsistent treatment of liability to reduce costs associated with interconnection facilities & upgrades.”*

Decision (D.) 94-06-038 established three options to assure payment to the purchasing utility for any future taxes: 1) pay the ITCC; 2) provide the utility a letter of credit for the value of the ITCC; or 3) execute an indemnity agreement and provide a guarantee for the value of the ITCC. Despite D.94-06-038, Southern California Edison (“SCE”) is known to have requested interconnection applicants to pay the ITCC upfront on projects interconnecting to SCE’s distribution system, despite stating elsewhere that it is allowing all three options. In contrast, while the Pacific Gas & Electric Company (“PG&E”) reserves the right to require—on a nondiscriminatory basis—an Interconnection Customer to provide such security, PG&E has not been requiring this for projects in its territory, let alone requiring upfront payment of the potential ITCC liability in full.

This proceeding should address inconsistency with D.94-06-038, inconsistency of treatment of interconnection customers within a utility service area, and encourage consistency in line with best practices between utilities.

ITCC charges, when applied, add roughly 30% to the cost of any upgrades associated with an interconnection request. As SCE territory’s average total in-front-of-the-meter (“IFOM”) upgrade costs are approximately \$150,000 per MW, these

charges represent the second largest contributor to interconnection costs, despite the de minimis risk of actual liability being imposed.”

- The Scoping Memo authorized eight working groups to address the issues stipulated in the Scoping Memo. Working Group One will include addressing Issue #7.
- ***The purpose of this effort is to address Issue #7 and to succinctly i) describe the issues assigned; ii) discuss and frame the relevant questions or considerations to move discussions forward from the outset; and iii) outline and provide a schedule showing how the group proposes to move toward resolution of Issue #7.***

### **Rule 21 Application of ITCC**

#### **Background**

- The Tax Reform Act of 1986 amended Internal Revenue Code Section (“IRC §”) 118(b) to exclude contributions in aid of construction (“CIAC”) from the general nontaxable treatment of contributions to the capital of corporations pursuant to IRC §118(a), i.e., CIAC’s became taxable to utilities.
- CPUC Decision 87-09-026 authorized investor-owned utilities under its jurisdiction, including PG&E, SDG&E and SCE (“Utilities”), to collect the tax gross-up, commonly referred to as the income tax component of the contribution (“ITCC”), on any taxable CIAC contributed to the Utilities by unrelated third parties.
- The purpose of ITCC is to mitigate the adverse economic implications to the Utilities for paying income taxes on the full value of the CIAC upfront while only being able to deduct the CIAC value in subsequent years over the tax depreciable life of the related asset.
- In 1988, the IRS issued CIAC guidance in the form of Notice 88-129 that exempted certain CIAC transactions from taxable income, but only interconnection transactions with generators if certain requirements were satisfied. Subsequent IRS notices were issued that expanded and clarified the exemption of CIAC from taxable income in certain interconnection transactions with generators. The IRS recently issued IRS Notice 2016-36 that modified and superseded previously issued IRS guidance regarding the general exclusion from taxable income of CIAC for certain interconnection transactions.
- CPUC Decision 94-06-038 authorized the Utilities to collect security in the form of cash, letter of credit or corporate guarantee from Qualifying Facilities for the tax risk associated with any CIAC involved in a nontaxable interconnection transaction pursuant to the IRS notices.

#### **SCE’s Application of ITCC to Rule 21 Transactions**

- SCE applies the general concepts and principles of D.94-06-038 in its Rule 21 transactions.
- To the extent the CIAC from an IFOM generator satisfies the requirement of IRS Notice 2016-36, SCE will not treat the CIAC as taxable and will collect the tax-related security equal to the ITCC amount in the form of a letter of credit, corporate guarantee or cash.

- To the extent the CIAC from a generator does not satisfy the requirement of IRS Notice 2016-36, SCE will treat the CIAC as taxable and will collect the tax-related the ITCC amount in the form of a cash payment.

#### **PG&E's Application of ITCC to Rule 21 Transactions**

- PG&E acknowledges the general concepts and principles of D.94-06-038 in its Rule 21 transactions.
- To the extent the CIAC from an IFOM generator satisfies the requirement of IRS Notice 2016-36, PG&E will not treat the CIAC as taxable and will not collect any tax-related ITCC security.
- To the extent the CIAC from a generator does not satisfy the requirement of IRS Notice 2016-36, PG&E will treat the CIAC as taxable and will collect the tax-related the ITCC amount in cash.

#### **SEMPRA's Application of ITCC to Rule 21 Transactions [**

- SEMPRA acknowledges the general concepts and principles of D.94-06-038 in its Rule 21 transactions.
- SEMPRA does not treat CIAC from IFOM generators as taxable and currently does not collect any tax-related ITCC security.

#### **Description of Assigned Issue #7**

#### **Consistency Issue**

- CPUC Decision 94-06-038 authorized the Utilities to collect security for the tax risk, but did not require the Utilities to collect the security and/or ITCC amount.
- Each Utility assesses its own risk tolerance to determine the appropriate approach within the general concepts and principles of D.94-06-038 in its Rule 21 transactions.
- The result of the current CPUC-approved policy is a varied approach with regard to the collection of ITCC and related ITCC security among the three Utilities.

#### **Relevant Questions and Considerations**

- Consistent with the fundamental conceptual principle of CIAC-related CPUC Decisions, the contributor causing any taxable event should continue to be primarily responsible for paying any tax-related consequences to the Utilities.
- Whether the current policy of authorizing the Utilities to collect ITCC or ITCC-related security based on their risk tolerance factors continues to be the best approach in addressing the risks associated with taxable CIAC's.

- **Recent CIAC Development Resulting from the Tax Cut and Jobs Act**