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August 11, 2014

VIA HAND DELIVERY

Rosemary Chiavetta
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor North
P.O. Box 3265
Harrisburg, PA 17105-3265

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SECRETARY'S BUREAU

Re: Joint Application of Peoples Natural Gas Company LLC, Peoples TWP LLC, and Equitable Gas Company, LLC for All of the Authority and the Necessary Certificates of Public Convenience (1) to Transfer All of the Issued and Outstanding Limited Liability Company Membership Interest of Equitable Gas Company, LLC to PNG Companies, LLC, (2) to Merge Equitable Gas Company, LLC with Peoples Natural Gas Company LLC, (3) to Transfer Certain Storage and Transmission Assets of Peoples Natural Gas Company LLC to Affiliates of EQT Corporation, (4) to Transfer Certain Assets between Equitable Gas Company, LLC and Affiliates of EQT Corporation, (5) for Approval of Certain Ownership Changes Associated with the Transaction, (6) for Approval of Certain Associated Gas Capacity and Supply Agreements, and (7) for Approval of Certain Changes in the Tariff of Peoples Natural Gas Company LLC - Docket Nos. A-2013-2353647; A-2013-2353649; A-2013-2353651

Request for Certification in Conjunction with Request for IRS Private Letter Ruling

Dear Secretary Chiavetta:

In December 2013, PNG Companies LLC, the parent of Peoples Natural Gas Company LLC ("Peoples"), acquired EQT's interests in Equitable Gas Company LLC ("Equitable") and Equitable was merged with Peoples. In the proceeding at the above-referenced docket, Peoples indicated that it intended to seek a private letter ruling ("PLR") from the Internal Revenue Service ("IRS") designed to permit Peoples to preserve some pre-transactional accumulated deferred federal income taxes ("ADIT") for the benefit of customers after the transaction.

In a "normal" taxable acquisition of utility assets, the ADIT balance associated with the acquired assets is extinguished, and the tax normalization rules do not permit it to be reflected for ratemaking purposes after the transaction. However, Peoples explained in the above-captioned proceeding that it may be able to preserve some amount of pre-transactional ADIT, because Peoples transferred certain transportation and storage assets (the "Midstream Assets") to EQT in exchange for a portion of the Equitable assets ("Distribution Assets"), with the remainder paid for with cash. From a tax perspective, the exchange of such Midstream Assets for a portion of Equitable Distribution Assets is expected to qualify as a non-taxable "like-kind exchange". However, the IRS has never previously considered how to apply the normalization rules to a non-taxable "like-kind exchange." Absent a PLR from the IRS, the required treatment of pre-transaction ADIT is highly uncertain.

Attached is a copy of the PLR request that Peoples and EQT intend to file with the IRS. It is a joint request by both parties to the asset exchange transaction, because resolution of the technical issue has implications for both parties.

IRS Rev. Proc. 2014 provides for comment by the utility's regulator and permits communication with the IRS by the consumer advocate in the jurisdiction in which the utility operates:

A letter ruling request that involves a question of whether a rate order that is proposed or issued by a regulatory agency will meet the normalization requirements of § 168(f)(2) (pre-Tax Reform Act of 1986, § 168(e)(3)) and former §§ 46(f) and 167(l) ordinarily will not be considered unless the taxpayer states in the letter ruling request whether – (1) the regulatory authority responsible for establishing or approving the taxpayer's rates has reviewed the request and believes that the request is adequate and complete; and (2) the taxpayer will permit the regulatory authority to participate in any Associate office conference concerning the request.

If the taxpayer or the regulatory authority informs a consumer advocate of the request for a letter ruling and the advocate wishes to communicate with the Service regarding the request, any such communication should be sent to: Internal Revenue Service, Associate Chief Counsel (Procedure and Administration), Attn: CC:PA:LPD:DRU, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044 (or, if a private delivery service is used: Internal Revenue Service, Associate Chief Counsel (Procedure and Administration), Attn: CC:PA:LPD:DRU, Room 5336, 1111 Constitution Ave., NW, Washington, DC 20224). These communications will be treated as third party contacts for purposes of § 6110.

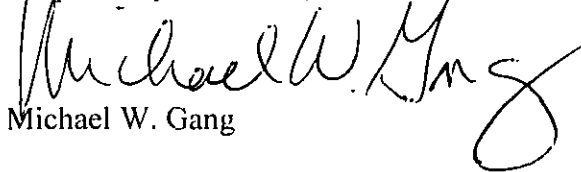
Rosemary Chiavetta
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By this filing, Peoples requests that the Commission advise the IRS that the Commission has reviewed the PLR request and that it is adequate and complete. Because this filing is related to the above-docketed proceedings, and to provide notice to any party that may seek to provide comments to the Commission or the IRS, copies have been served upon all parties in that proceeding.

As counsel for Peoples, I have contacted counsel for the Bureau of Investigation & Enforcement, Office of Consumer Advocate and Office of Small Business Advocate and represent that such counsel do not object to the filing of the attached request for Private Letter Filing with the Internal Revenue Service.

Copies will be provided as indicated on the Certificate of Service.

Respectfully submitted,



Michael W. Gang

MWG/jl
Enclosure

cc: Certificate of Service
Paul T. Diskin
Robert F. Young

Draft of July 9, 2014

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HAND DELIVER

Associate Chief Counsel
Passthroughs & Special Industries
Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:DRU, Room 5336
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Joint Ruling Request for LDC Funding LLC (EIN# 26-3349481) and EQT Corporation (EIN# 25-0464690)

Dear Sir or Madam:

LDC Funding LLC ("LDC Funding") and EQT Corporation ("EQT") (each a "Taxpayer" and together, the "Taxpayers") jointly request rulings regarding the application of the depreciation normalization rules of §168(i)(9) of the Internal Revenue Code of 1986, as amended ("Code") and Treas. Reg. §1.167(l)-1 (together, the "Normalization Rules") to the exchange of like kind properties between the Taxpayers which exchange is governed by Code §1031.

A check in the amount of \$38,000 is enclosed which represents the user fee associated with this request (\$19,000 for each Taxpayer).

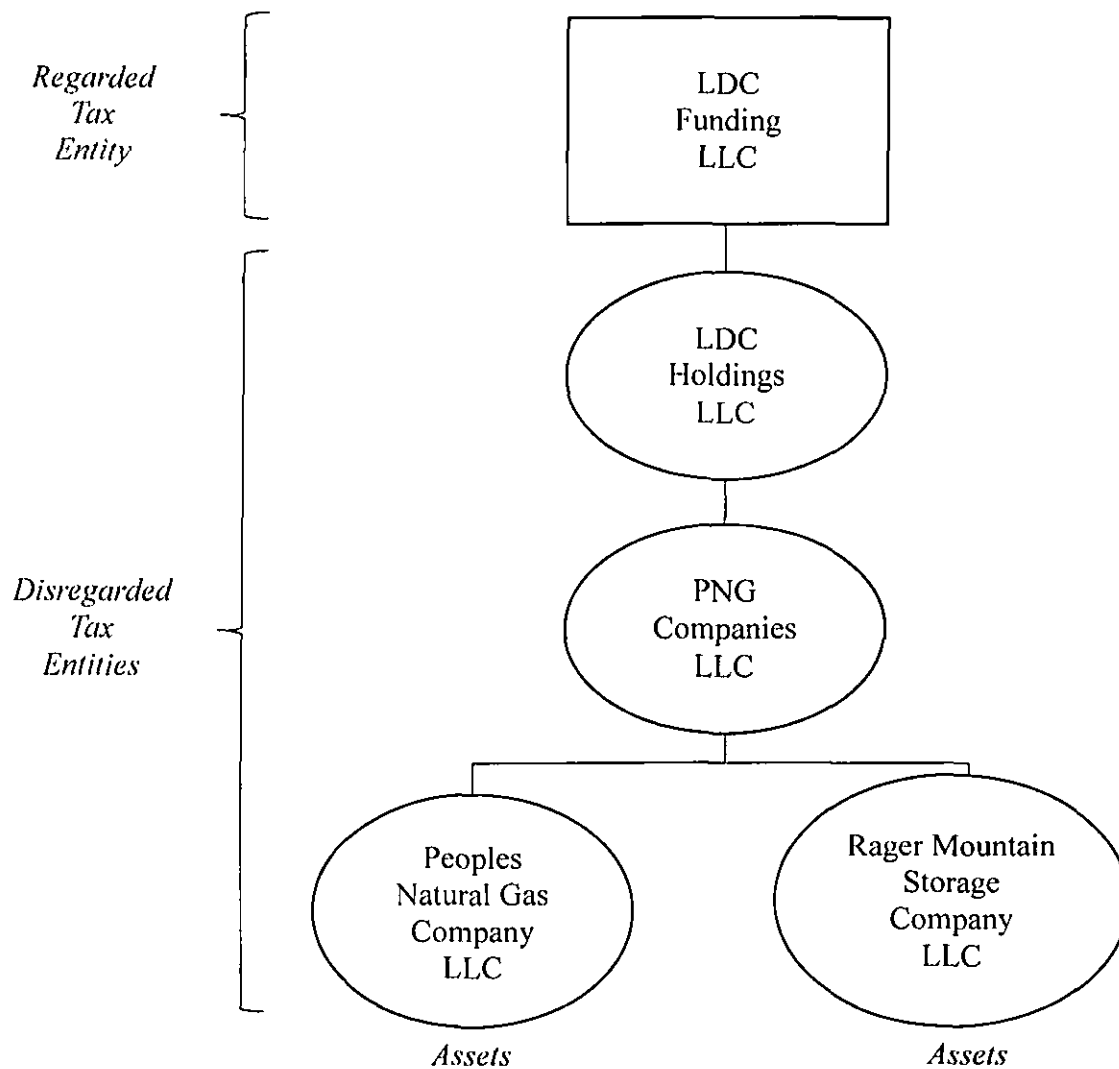
STATEMENT OF FACTS

Except as otherwise noted, the descriptions of LDC Funding and EQT which follow refer to their respective organizational groups and operations before completion of the "Asset Exchange" described on pages 6 through 8.

LDC Funding

LDC Funding is a Delaware limited liability company that is classified as a corporation for federal income tax purposes. Its principal place of business is located at 375 North Shore Drive, Pittsburgh, Pennsylvania 15212 and its taxpayer identification number is 26-3349481. LDC Funding employs the accrual method of accounting and reports on a calendar-year basis. It files its federal income tax return with the Internal Revenue Service Center in Ogden, Utah and is under the audit jurisdiction of the Large Business and International Division of the Internal Revenue Service (the "IRS" or "Service").

LDC Funding owns all of the membership interests in LDC Holdings LLC ("LDC Holdings") which owns all of the membership interests in PNG Companies LLC ("PNG Companies"). PNG Companies owns all of the membership interests in Peoples Natural Gas Company LLC ("Peoples"). In addition, PNG Companies owns all of the membership interests in Rager Mountain Storage Company LLC ("RMSC"). LDC Holdings, PNG Companies, Peoples and RMSC are all disregarded entities for federal income tax purposes. Thus, for federal income tax purposes, *LDC Funding is treated as directly owning the assets and directly conducting the underlying business operations of those entities.* This structure is depicted as follows:



Peoples is a natural gas local distribution company that provides service to approximately 360,000 residential, commercial and industrial customers in southwestern Pennsylvania. The Peoples natural gas distribution business is subject to regulation by the Pennsylvania Public Utility Commission ("PPUC") with respect to the terms and conditions of service and particularly as to the rates it can charge for the provision of service.

Peoples leases certain assets to RMSC which uses the leased assets to provide natural gas storage service to customers.¹ The gas storage and transmission (in which, *inter alia*, the RMSC assets are employed) is subject to regulation by the Federal Energy Regulatory Commission ("FERC") with respect to the terms and conditions of service and particularly as to the rates that can be charged for the provision of these services. Rates for the Peoples natural gas distribution business and the natural gas storage and transmission business are established on a "rate of return" (*i.e.*, cost) basis.

EQT

EQT is a publicly traded corporation that is incorporated under the laws of the Commonwealth of Pennsylvania. EQT's principal place of business is located at 625 Liberty Avenue, Pittsburgh, Pennsylvania 15222 and its taxpayer identification number is 25-0464690. EQT employs the accrual method of accounting and reports on a calendar-year basis. EQT is the common parent of a group of companies that files a consolidated federal income tax return with the Internal Revenue Service Center in Ogden, Utah and is under the audit jurisdiction of the Large Business and International Division of the IRS.

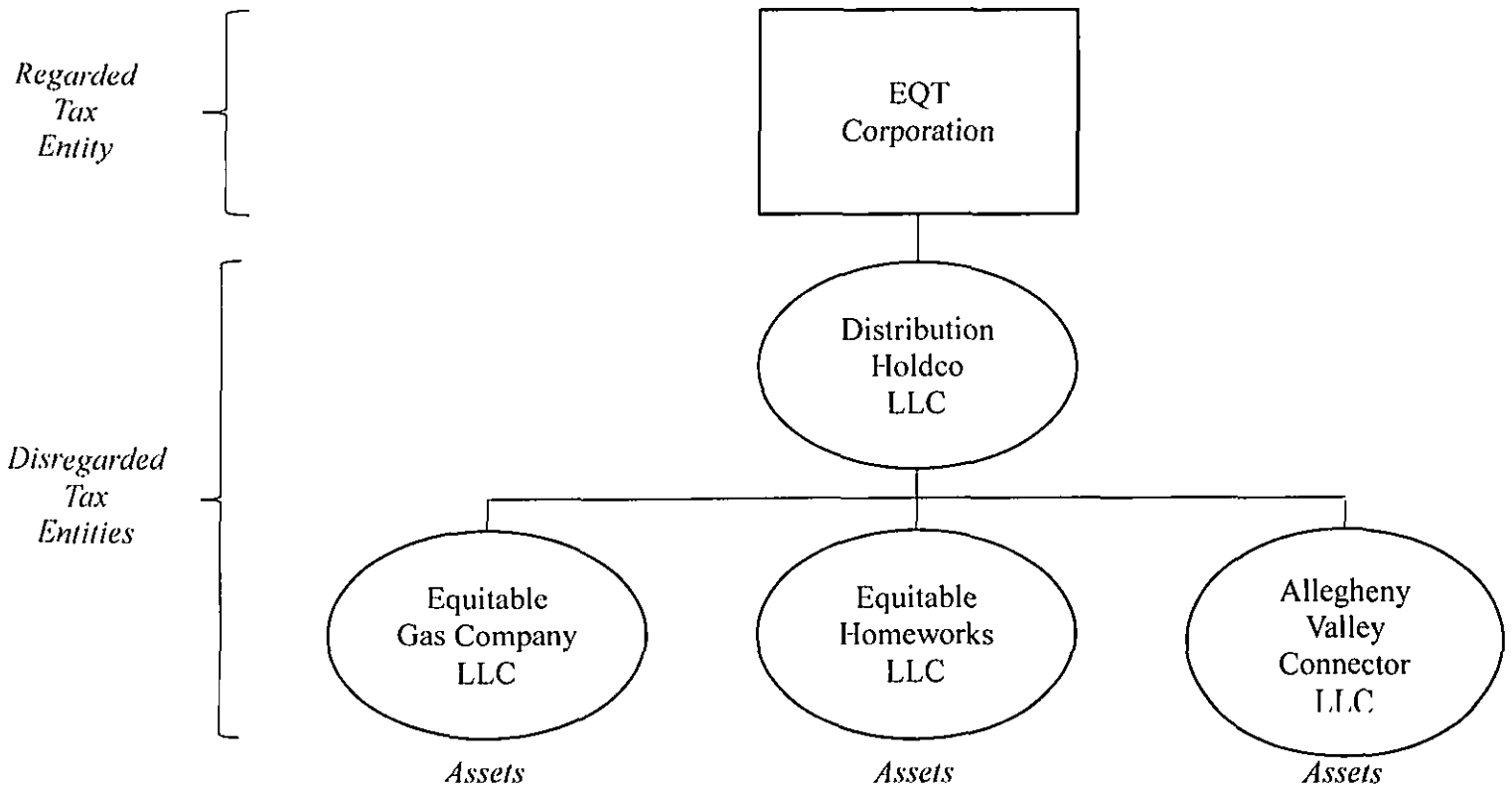
EQT and its affiliates conduct operations in four segments of the natural gas industry:

1. "upstream" operations including the production of natural gas, natural gas liquids and oil;
2. "midstream" operations including the gathering, transmission and storage of natural gas as well as the sale of natural gas and natural gas liquids;

¹ Because Peoples and RMSC are both disregarded entities, the leasing transaction is also disregarded.

3. "commercial" operations including the sale in bulk of natural gas to other marketers, power generation or local distribution companies; and
4. "downstream" operations including natural gas local distribution and service line protection.

EQT's local gas distribution operations are conducted by Equitable Gas Company, LLC ("EGC") and its service line protection operations by Equitable Homeworks, LLC ("EH"). Distribution Holdco, LLC ("DH") owns all of the membership interests in both EGC, EH and Allegheny Valley Connector, LLC ("AVC"), an entity formed in connection with the Asset Exchange described below. EQT owns all of the membership interests in DH. DH, EGC, EH and AVC are all disregarded entities for federal income tax purposes. Thus, for federal income tax purposes, EQT is treated as directly owning the assets and directly conducting the underlying business operations of those entities. This structure is depicted as follows:



EGC distributes and sells natural gas to approximately 260,000 residential, commercial and industrial customers in southwestern Pennsylvania, to various municipalities in northern West Virginia and, to a limited extent, to farm tap customers in Kentucky. EGC is subject to regulation by the PPUC and the Public Service Commission of West Virginia with respect to the terms and conditions of service and particularly as to the rates it can charge for the provision of service.² Its rates are established on a "rate of return" (*i.e.*, cost) basis.

The "Asset Exchange"

On December 19, 2012, EQT and DH executed a Master Purchase Agreement ("MPA") and an Asset Exchange Agreement ("AEA"), as amended from time to time (collectively, the "Agreements") with PNG Companies.

After receiving the necessary state and federal regulatory approvals, Taxpayers consummated the following transaction on December 17, 2013.

- DH transferred all of the membership interests in EGC and EH to PNG Companies.³ For federal income tax purposes, because EGC and EH are disregarded, EQT was deemed to transfer the assets of EGC and EH to LDC Funding.
- Simultaneously, PNG Companies transferred cash to DH and caused Peoples to deed certain of its regulated storage and transmission assets (the "Midstream

² None of the properties included in the Asset Exchange described below are subject to the jurisdiction of the regulators in either Kentucky or West Virginia. Therefore, the tax consequences of that transaction do not implicate utility regulation in those states.

³ EGC was merged into Peoples shortly thereafter. Thus, after the transaction, all of EGC's assets, including the Distribution Assets (described below), reside in Peoples.

Assets")⁴ to AVC. For federal income tax purposes, because PNG Companies and Peoples are disregarded, LDC Funding was deemed to transfer the Midstream Assets plus cash to EQT.

Pursuant to Code §1031, EQT identified those assets (the "Distribution Assets") that were exchanged for the Midstream Assets, treating the Distribution Assets as "relinquished property" and treating the Midstream Assets as "replacement property." Pursuant to Code §1031, LDC Funding treated the Midstream Assets as "relinquished property" and treated certain of the Distribution Assets as "replacement property." As each party experienced exchange-group deficiencies and/or surpluses, each Taxpayer recognized insignificant gain or loss on the Code §1031 exchange of its respective relinquished property⁵ and carried over the tax basis in the relinquished property to the replacement property (which tax basis will be adjusted for any gains or losses on exchange-group surpluses and deficiencies in accordance with Code §1031(d)).⁶

For regulatory purposes, Peoples will record the Distribution Assets it received at the same regulatory book value at which those assets had been recorded by EGC immediately prior to the Asset Exchange. Similarly, AVC will record the Midstream Assets it received at the same regulatory book value at which those assets had been recorded prior to the Asset Exchange. The regulatory book value of the Distribution Assets was approximately equal to the regulatory book value of the Midstream Assets (approximately \$140 million).

⁴ The Midstream Assets include, *inter alia*, the membership interests in RMSC.

⁵ Taxpayers do not believe these gains or losses will impact the legal analysis applicable to this ruling request. They will, therefore, be ignored.

⁶ EQT recognized a taxable gain to the extent of the cash received for the assets other than the Distribution Assets. Neither Taxpayer is requesting a ruling regarding the nature of the respective relinquished property or replacement property nor the federal income tax treatment of the Asset Exchange.

Prior to the Asset Exchange, the Distribution Assets and the Midstream Assets had been used in the provision of regulated service to residential, commercial and/or industrial customers. For federal income tax purposes, each Taxpayer had claimed accelerated depreciation (including bonus depreciation) to the extent allowable on the assets it owned.

The Midstream Assets are comprised primarily of gas storage plant and transmission plant. Gas storage plant primarily includes:

1. land and rights-of-way;
2. structures and improvements;
3. wells;
4. storage leaseholds and rights;
5. storage pipelines;
6. compressor station equipment; and
7. measuring and regulating station equipment.

Transmission plant primarily includes:

1. land and rights-of-way;
2. structures and improvements;
3. main pipelines; and
4. measurement, compression and regulation equipment.

The Distribution Assets primarily include:

1. land and rights-of-way;
2. structures and improvements;
3. main and service pipelines; and
4. measurement, compression and regulation equipment.

Prior to the Asset Exchange (and in compliance with the Normalization Rules) each Taxpayer had recorded an accumulated deferred income tax ("ADIT") reserve to reflect the deferral of federal income taxes attributable to its claiming accelerated depreciation with respect to its public utility assets. On the closing date, Peoples (the disregarded entity owned by LDC Funding) had a tax basis in the Midstream Assets of approximately \$100 million and the

associated ADIT reserve balance was approximately \$14 million. EGC (the disregarded entity owned by EQT) had a tax basis in the Distribution Assets of approximately \$30 million and the associated ADIT reserve balance was approximately \$39 million.⁷ Since Code §1031 applies to the Asset Exchange, neither LDC Funding nor EQT would recognize current tax gain from the Asset Exchange and, consequently, the ADIT balances reflected on Peoples' and EGC's regulatory books would not be reversed due to current tax payments to the IRS.

RULINGS REQUESTED

Taxpayers respectfully request the following rulings:

- 1. In the context of a Code §1031 exchange, it would be inconsistent with the requirements of Code §168(i)(9) and Treasury Regulations §1.167(l)-1 for Peoples (LDC Funding) to recognize for ratemaking purposes a depreciation-related ADIT balance attributable to its replacement property in excess of the depreciation-related ADIT balance attributable to its relinquished property.*
- 2. In the context of a Code §1031 exchange, it would be inconsistent with the requirements of Code §168(i)(9) and Treasury Regulations §1.167(l)-1 for AVC (EQT) to recognize for ratemaking purposes a depreciation-related ADIT balance attributable to its replacement property in excess of the depreciation-related ADIT balance attributable to its relinquished property.*
- 3. If the answer to Ruling #1 above is affirmative, Peoples' (LDC Funding's) prospective treatment of the federal ADIT balance attributable to the Distribution Assets acquired in the Asset Exchange as though it had been actually generated by those assets (i.e., for purposes of determining both subsequent ADIT originations and reversals) will be consistent with the requirements of Code §168(i)(9) and Treasury Regulations §1.167(l)-1.*

⁷ In each case, the ADIT balance does not reflect the impact of any net operating loss ("NOL") carryforward (i.e., it is not reduced on account of the lack of tax deferral produced by claiming depreciation deductions that simply created or increased an NOL carryforward).

4. *If the answer to Ruling #2 above is affirmative, AVC's (EQT's) prospective treatment of the federal ADIT balance attributable to the Midstream Assets acquired in the Asset Exchange as though it had been actually generated by those assets (i.e., for purposes of determining both subsequent ADIT originations and reversals) will be consistent with the requirements of Code §168(i)(9) and Treasury Regulations §1.167(l)-1.*

STATEMENT OF LAW

Code §168(f)(2) provides that MACRS depreciation does not apply to any public utility property if the taxpayer does not use a normalization method of accounting.

Code §168(i)(9) provides that, in order to use a normalization method of accounting, if a utility's tax depreciation deduction differs from its regulatory depreciation expense, the utility must establish and adjust a reserve to reflect the deferral of taxes resulting from such difference. It further provides that any procedure or adjustment that is used for tax expense, depreciation expense or the reserve for deferred taxes must be used with respect to the other two and with respect to rate base (the consistency rules).

Code §1031(a) provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

Code §1031(d) provides that if property was acquired in an exchange described in §1031, then the basis shall be the same as that of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized on such exchange.

Treas. Reg. §1.167(l)-1(h)(2)(i) provides that a utility's ADIT reserve established pursuant to the Normalization Rules cannot be reduced except when the depreciation timing differences reverse, to reflect asset retirements or when the period for depreciation expires.

Treas. Reg. §1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of accounting if the reserve by which rate base is reduced exceeds the amount of such reserve used in determining the taxpayer's expense in computing cost of service in such ratemaking.

In PLR 8413074 (Dec. 29, 1983), the Service addressed certain consequences under the Normalization Rules of the tax-free reorganization of a regulated telephone company. The Service ruled, *inter alia*, that the taxpayer who transferred regulated assets to another regulated entity must remove the ADIT balance associated with the transferred assets from its regulated books of account. The Service also ruled that the transferee could reflect the ADIT balance associated with the transferred assets on its regulated books of account.

In PLR 9418004 (Jan. 14, 1994), the taxpayer acquired regulated telephone assets in a taxable deemed asset purchase. The Service ruled, *inter alia*, that the transferor must remove the ADIT balance associated with the transferred assets from its regulated books of account.

In PLR 9447009 (Aug. 4, 1994), the taxpayer acquired a regulated gas transmission business in a taxable deemed asset purchase. The regulator proposed to reflect the ADIT balance that existed immediately prior to the transaction on the taxpayer's regulatory books of account immediately after the transaction. The Service ruled that, as a result of the asset retirement that occurred upon the sale, the ADIT balance associated with the acquired assets ceased to exist.

The Service also ruled that any subsequent reduction in rate base on account of that ADIT balance would violate the Normalization Rules.

In PLR 9652008 (Dec. 27, 1996), the taxpayer acquired regulated gas transmission assets in a taxable deemed asset purchase. The Service ruled that as a result of the asset retirement that occurred upon the sale, the ADIT balance associated with the acquired assets ceased to exist. The Service also ruled that any subsequent reduction in rate base on account of that ADIT balance would violate the Normalization Rules.

In PLR 9747020 (Nov. 21, 1997), the taxpayer implemented a tax-free reorganization of utility assets. As one of the steps in the plan, a utility distributed certain regulated utility assets to its parent which immediately re-transferred those assets to another subsidiary. The Service concluded that the failure to remove the ADIT balance associated with the distributed assets from the distributing utility's books would violate the Normalization Rules. The Service also ruled that the ADIT balance associated with the transferred assets could follow the assets and be reflected on the ultimate transferee's books of account.

In PLR 9846006 (Aug. 7, 1998), the taxpayer sold regulated telephone assets in a taxable sale. The Service ruled that the ADIT balance that existed prior to the purchase ceased to exist as a result of the retirement of the assets by virtue of the sale.

In PLR 200004038 (Oct. 26, 1999), the taxpayer sold regulated electric utility assets in a taxable sale. The Service ruled, *inter alia*, that, due to the retirement of the assets caused by the sale, the ADIT balance ceased to exist.

In PLR 200434007 (Aug. 20, 2004), the taxpayer bought a regulated gas transmission utility in a taxable deemed asset purchase. The Service ruled that the ADIT balance that existed

prior to the purchase ceased to exist as a result of the retirement of the assets by virtue of the sale.

DISCUSSION AND ANALYSIS

Requested Rulings #1 and #2

General

Prior to the Asset Exchange, each Taxpayer had established a reserve pursuant to the Normalization Rules to reflect the deferral of taxes resulting from the difference between the tax depreciation expense and regulatory depreciation expense with respect to its respective assets. Taxpayers are aware that the Service has addressed the requirements under the Normalization Rules of several types of asset transfers. However, they have not identified any authority wherein the Service has considered those requirements in the context of a Code §1031 exchange, *i.e.*, where the tax basis of the Code §1031 replacement property is the substituted tax basis of the Code §1031 relinquished property. In the context of a Code §1031 exchange, Taxpayers believe that the most appropriate treatment would be to conform the Normalization Rules to the Code §1031 basis rules, *i.e.*, the substituted basis rules. Such harmonization would require the establishment of a substituted ADIT reserve applicable to the replacement property. In other words, Taxpayers believe that, to be consistent with the Normalization Rules, each Taxpayer should associate the ADIT balance attributable to its relinquished property with its replacement property. This treatment is more appropriate than either (1) entirely eliminating the ADIT

reserve attributable to the relinquished property⁸ or (2) carrying over the ADIT balance from the prior owner of the assets.⁹

The Normalization Rules

Accelerated depreciation represents the implementation of Congress's decision to stimulate the economy by subsidizing the capital cost of certain depreciable business assets through the tax system. In establishing the Normalization Rules, Congress intended to prevent the financial benefit of accelerated depreciation claimed by regulated utilities from being extracted through the rate-setting process, thereby reducing or eliminating the intended subsidy. Because of the nature of the utility ratemaking process, the compromising of this benefit is most likely to occur in one of two ways: (1) the direct flow-through of the financial benefit to ratepayers or (2) the provision to ratepayers of a financial benefit attributable to accelerated depreciation that exceeds the benefit actually received by the utility. Both mechanisms reduce the benefit of accelerated depreciation to the subject utility and, accordingly, the Normalization Rules incorporate restrictions with respect to both.

The Normalization Rules require that, in ratemaking and on its regulatory books of account, a utility must reflect the tax deferred by virtue of claiming accelerated depreciation in a reserve for deferred taxes. This requirement is the mechanism that prevents the direct flow-through of the financial benefit of accelerated depreciation to ratepayers. The regulations do permit the amounts properly reflected in a reserve account (*i.e.*, the depreciation-related ADIT

⁸ As would be the case in a taxable transaction (See, *e.g.*, PLRs 9418004, 9447009, 9652008, 9846006, 200004038, and 200434007 and discussion below).

⁹ As would be the case in a "step-in-the-shoes" transaction (See, *e.g.*, PLRs 8413074 and 9447020 and discussion below).

balance) to be used as a reduction in rate base or to be otherwise treated as no-cost capital.¹⁰

This provides a derivative financial benefit to ratepayers. However, the Normalization Rules impose a limit on the provision of this derivative benefit. The guidance sought relates to this limitation – the limitation on the amount by which rate base may be reduced in connection with a Code §1031 exchange of utility assets.

Asset Transfers – Transferor’s ADIT Limitation

Taxpayers are not aware of any situations in which the Service has permitted the retention of the ADIT balance associated with assets that are no longer recognized in a utility’s ratemaking.

The bulk of the instances in which the Service has considered the implications under the Normalization Rules of asset dispositions have involved taxable sales (or deemed taxable sales) of assets. In each of these taxable transactions, the Service concluded that the ADIT balance associated with the assets sold cannot remain on the transferor's regulatory books of account. The authority underlying the transferor’s inability to retain its ADIT balance is contained in Treas. Reg. §1.167(l)-1(h)(2)(i) which provides:

An additional exception is that the aggregate amount allocable to deferred tax under section 167(l) may be properly adjusted to reflect asset retirements...

The Service referenced this section of the regulations to support its conclusions in PLR 9418004, PLR 9447009, PLR 9652008, PLR 9846006, PLR 200004038 and PLR 200434007. These rulings indicate that a taxable disposition of assets is considered a "retirement" for purposes of

¹⁰ In this regard, the legislative history of the Tax Reform Act of 1969 states: "Where normalization is used, this bill in no way diminishes whatever power the agency may have to require that the deferred taxes reserve be excluded from the base upon which the utility's permitted rate of return is calculated." House of Representatives Report No. 91-413 (Part 1), 1969-3 CB 283.

Treas. Reg. §1.167(l)-1(h)(2)(i). Moreover, notwithstanding the permissive wording of the regulation ("*may be properly adjusted*"), in all of the cited rulings, the Service treated it as a mandate such that the ADIT balance was required to be adjusted (*i.e.*, removed).

But this "retirement" rationale was also employed in the two instances¹¹ in which the Service considered how the Normalization Rules apply to non-taxable asset dispositions. The first was in PLR 8413074. This ruling is commonly understood to have been issued in connection with the breakup of the AT&T system. One step in the larger reorganization required each of 22 regulated telephone companies to create a new subsidiary to which would be transferred certain operating assets. These assets were regulated prior to the transfer and would remain so after the transfer. With regard to the overall reorganization and its component parts, the Service basically ruled that the transaction would be tax-free. The taxpayer requested rulings, *inter alia*, that the ADIT balances associated with the assets transferred to the new subsidiaries must be removed from the transferors' books of account. The Service issued the requested ruling articulating three supporting rationales:

- The transfer of an asset represents a "retirement" of that asset insofar as the transferor is concerned and that Treas. Reg. §1.167(l)-1(h)(2)(i) requires an adjustment to the ADIT reserve upon a retirement;
- If the ADIT reserve were not reduced to reflect the transfer, Treas. Reg. §1.167(l)-1(h)(6)(i) would be violated because the amount excluded from the transferor's rate base would not be consistent with the calculation of its tax expense for cost of service

¹¹ The only two instances of which the Taxpayers are aware.

and would exceed the amount by which rate base can properly be reduced under that provision; and;

- If the ADIT reserve were not adjusted to reflect the transfer, the transferor would recognize ADIT while not including the property itself in rate base nor including any amount of related depreciation in either its tax expense or depreciation expense, contrary to the requirements of the consistency rules of Code §168(e)(3)(C) [now Code §168(i)(9)(B)].

The second ruling involving a non-taxable transaction was PLR 9747020. This ruling also involved a tax-free reorganization. As one of the steps in the plan, a utility distributed certain regulated utility assets to its parent, which immediately transferred those assets to another subsidiary. The transferred assets were subject to regulation by the same regulators both before and after the transaction. The taxpayer intended to remove the entire ADIT balance associated with the transferred assets from the distributing corporation's regulatory books. The Service ruled that the failure to remove the ADIT balance associated with the distributed assets from the distributing corporation's regulatory books would violate both the "retirement" and the consistency requirements.¹² Thus, the reach of the "retirement" rationale appears to transcend taxability, applying to both taxable and non-taxable dispositions.

¹² The ruling states, "Section 1.167(l)-1(h)(2)(i) of the regulations provides for the depreciation reserve established for public utility property from which reductions must be made for depreciation/tax differences and retirements. After a disposition, it is improper for that reserve to remain on the transferor's books. After a transfer of public utility property, the transferor must remove the property from its regulatory books of account, and the deferred reserve cannot be used to reduce the transferor's rate base or cost of service. Failure to reduce the reserve would violate the consistency requirements of section 1.167(l)-1(h)(6)(ii), former section 168(e)(3), and current section 168(i)(9)."

Further, the Service has ruled that, when regulated assets merely become deregulated, the ADIT balance related to those assets must be removed from the owner's regulated books of account.¹³ This holding relied primarily on the "consistency rules" which require that ADIT, rate base, tax expense and depreciation expense be symmetrically handled in ratemaking.¹⁴ Because the deregulated assets would no longer be depreciated for regulatory purposes, continuing to recognize the related ADIT balance would constitute an inconsistency. Thus, in some cases, a utility may be required to remove the ADIT balance associated with regulated assets from its regulated books of account even if it does not dispose of the assets in question from a tax perspective.

In sum, the Service has uniformly interpreted the Normalization Rules to require the removal of depreciation-related ADIT balances attributable to assets that are no longer recognized in a utility's ratemaking.

Asset Transfers – Transferee's ADIT Limitation

The Service has ruled that the Normalization Rules permit a transferee to succeed to a transferor's ADIT balance only in very limited circumstances.

In the two previously-cited rulings in which the Service addressed non-taxable asset dispositions, it concluded that the ADIT balance could follow the assets. In PLR 8413074 (the AT&T divestiture ruling), this conclusion was pronounced with virtually no discussion or analysis. All of the analysis in the ruling addressed the treatment of the transferor. However, in PLR 9747020, the Service did articulate a basis for its conclusion. In that ruling, the regulated

¹³ See PLR 8730017 and PLR 8920025.

¹⁴ Code §168(i)(9)(B)(ii).

assets were ultimately transferred to an affiliate within the consolidated group. With regard to the transferee, the Service looked to Code §168(i)(7) that addresses, *inter alia*, transfers within a consolidated group of corporations. The Service noted that, with regard to so much of the transferor's tax basis that is carried over, the transferee "steps into the shoes" of the transferor. In such a situation, the transferee takes over the transferor's tax attributes which includes the "...168 attributes of section 168(i)(9)..."

By contrast, in three of the previously referenced PLRs that involved actual or deemed taxable asset sales,¹⁵ the Service also addressed the transferee's ability to recognize the asset-related ADIT balance on its regulatory books. In each of the three rulings, the Service concluded that the ADIT balance could not follow the assets. All three rulings considered whether or not there was continuity with regard to depreciation as between the transferee and the transferor (*i.e.*, whether the transferee "steps into the shoes" of the transferor with regard to depreciation). In these rulings, the Service cited to the following factors as indicating that the transferee did not "step into the shoes" of the transferor for depreciation purposes: (1) the transferee received a new, not a carryover, basis in the assets; (2) the transferee was not bound by the transferor's depreciation elections; and (3) the transferee obtained a new "placed in service" date. This lack of continuity between the asset transferor and transferee drove the conclusion that the ADIT balance could not carry over.

The body of rulings addressing the transferee's ability to carry over the transferor's ADIT balance indicates that a transferee may not record the transferor's ADIT balance associated with

¹⁵ PLR 9418004, PLR 9447009 and PLR 9652008.

regulated assets unless the transferee "steps into the shoes" of the transferor regarding depreciation with respect to the transferred assets.

The Alternatives Potentially Applicable to Taxpayers

To determine the maximum ADIT balance that the Normalization Rules permit Taxpayers to record after the Asset Exchange, Taxpayers have identified three alternative methodologies. In considering these alternatives, the facts of Taxpayers' situation should be borne in mind, as they help understand the implications of each of the alternatives. Those facts are presented in tabular form below (all numbers are estimates based on current data available to Taxpayers).

The first table reflects Taxpayers' facts prior to the Asset Exchange. Succeeding tables reflect the impact of each of the three alternatives.

PRIOR TO ASSET EXCHANGE		
	Midstream Assets (Owned by LDC Funding)	Distribution Assets (Owned by EQT)
BOOK VALUE	\$140 Million	\$140 Million
TAX BASIS	\$100 Million	\$30 Million
ADIT BALANCE	\$14 Million	\$39 Million

The three alternatives are:

1. The ADIT balance is limited to the balance associated with the relinquished property that each Taxpayer transferred in the Asset Exchange as that balance existed immediately prior to the Asset Exchange (the "substitution" of Taxpayers' ADIT balance);
2. No ADIT balance whatsoever can be recognized; or

3. The ADIT balance is limited to the balance associated with the replacement property as that balance existed immediately prior to the Asset Exchange when the replacement property was owned by the counterparty to the transaction (the "carryover" of counterparty's ADIT balance).

Each of these will be addressed in turn.

Substituted ADIT Reserve

A first alternative would be to allow each Taxpayer to retain the ADIT balance it had previously accumulated in connection with the relinquished property and to apply it to the replacement property. Under this alternative, the result would be:

AFTER ASSET EXCHANGE		
	Midstream Assets (Owned by EQT)	Distribution Assets (Owned by LDC Funding)
BOOK VALUE	\$140 Million	\$140 Million
TAX BASIS	\$30 Million	\$100 Million
ADIT BALANCE	\$39 Million	\$14 Million

This alternative would create somewhat of a regulatory discontinuity. Notwithstanding that the relinquished property is used in a continuation of the trade or business conducted prior to the Asset Exchange, and notwithstanding that none of the pre-transaction ADIT balance was paid (due to the application of Code §1031), continuing ratepayers of both the Midstream Assets and the Distribution Assets would receive a level of ADIT benefit that would be different from the level of such benefit they received immediately prior to the transaction.

On the other hand, this treatment would synchronize Taxpayers' ADIT balances with their respective tax bases. Each utility's ratepayers would receive the benefit of no more than and no less than the cost-free capital that such utility actually generated through accelerated depreciation – notwithstanding that, in each case, the cost-free capital was generated by a different set of regulated assets. Thus, as between each utility and its ratepayers (ignoring for this purpose the identity of any specific group of ratepayers), this alternative provides the split of the benefits of accelerated depreciation that is contemplated by the Normalization Rules.

In terms of dealing with the existing transferee/transferor authorities, the premise underlying the operation of Code §1031 should be considered. In this regard, HR Rep. No. 704, 73d Cong., 2d Sess. (1934), reprinted in 1939-1 CB (pt. 2) 554, 564, provides:

...[B]ut if the taxpayer's money is still tied up in the same kind of property as that in which it was originally invested, he is not allowed to compute and deduct his theoretical loss on the exchange, nor is he charged with a tax upon his theoretical profit. The calculation of the profit or loss is deferred until it is realized in cash, marketable securities, or other property not of the same kind having a fair market value.

In other words, where a taxpayer has disposed of certain assets and received in return certain similar assets, the taxpayer's investment in the transferred assets has not been liquidated but continues on in the acquired assets. A taxpayer's substituted basis in the assets received places the taxpayer in essentially the same position it would have occupied had the transaction not taken place – a fact consistent with the continuing investment proposition. The notion of a continuing investment suggests that the analysis of Taxpayers' positions should not be as a transferor and a transferee, viewed discretely. Continuity suggests a more holistic analysis viewing the Asset Exchange as a single transaction – or, perhaps, even as a non-transaction for which the transferor/transferee analysis is inappropriate.

In this regard, the continuing investment construct may also be seen as a variation on the "step into the shoes" theme which the Service used as the basis for its conclusion in its ADIT balance carryover rulings.¹⁶ In those rulings, one taxpayer stepped into another taxpayer's shoes with respect to a group of transferred assets. The Service concluded that, because the tax bases of the assets did not change, the ADIT associated with the transferred assets need not change. By contrast, in the present case, one taxpayer has not "stepped into the shoes" of another taxpayer. Instead one set of assets essentially "steps into the shoes" of another set of assets. A logical perspective is that this type of "reverse step into the shoes" transaction merits a change in the ADIT balance associated with the replacement property, to conform to the "regular" tax liability associated with the taxpayer's continuing investment. In this way, ADIT balance remains synchronized with asset basis.

And, not coincidentally, this alternative recognizes that Taxpayers derived benefits from accelerated depreciation prior to the Asset Exchange, that those benefits continue to exist after the Asset Exchange and that Taxpayers' ratepayers have a logical and an equitable right to have those benefits reflected in their rates.

The ruling position of the Service in the area of asset transfers seems always to have been dictated by the actual tax position of the subject taxpayer. The "substituted basis" alternative appears to embody the treatment that is most observant of and consistent with Taxpayers' tax positions. Consequently, notwithstanding the regulatory discontinuity described above, Taxpayers believe that this alternative represents the preferable rule under its circumstances.

¹⁶ PLRs 8413074 and 9747020.

No ADIT Reserve

The second alternative would be to deny either Taxpayer the ability to reflect any ADIT balance whatsoever on its regulatory books. Under this alternative, the result would be:

AFTER ASSET EXCHANGE		
	Midstream Assets (Owned by EQT)	Distribution Assets (Owned by LDC Funding)
BOOK VALUE	\$140 Million	\$140 Million
TAX BASIS	\$30 Million	\$100 Million
ADIT BALANCE	\$0 Million	\$0 Million

In the Asset Exchange, each Taxpayer was both a deemed transferor of assets and a deemed transferee of assets. Each of these statuses can be separately evaluated under the authorities discussed above.

If the general rule governing transferors were applicable, neither utility would be permitted to retain on its regulated books any of the ADIT balance relating to the relinquished property. In fact, the Asset Exchange could be analogized to a taxable disposition or "retirement," requiring each utility to eliminate the ADIT balance associated with its relinquished property from its books of account.

Regarding Taxpayers' status as transferees, the mechanics of Code §1031 do not cause either Taxpayer to "step into the shoes" of its respective counterparty with respect to depreciation of the replacement property. In particular, neither Taxpayer's tax basis in its replacement property will be established by reference to its counterparty's tax basis. Nor do the counterparty's depreciation-related elections carry over to the replacement property. Thus, the

Asset Exchange is distinguishable from the non-recognition transactions in which the Service has permitted a pre-existing ADIT balance to be carried over.

However, such a result seems hyper-technical and is unnecessary to preserve the benefits of accelerated depreciation to utilities (after all, the purpose of the Normalization Rules). During the period that each Taxpayer owned its relinquished property, such property generated ADIT balances and the ADIT balances were properly reflected as an offset to rate base. As a result of the application of Code §1031, the Asset Exchange did not result in the reversal of the deferred tax liabilities represented by the ADIT balances, *i.e.*, Taxpayers have not repaid the tax savings associated with accelerated depreciation back to the government. If Taxpayers were not permitted to recognize any ADIT balance following the Asset Exchange, then, they would not be able to pass the derivative benefit of zero-cost funds (\$14 million in the case of Peoples and \$39 million in the case of AVC) through to their ratepayers. Such a result would mandate the retention of a depreciation-related benefit that exceeds the policy scope of the Normalization Rules. Thus, there appears to be no policy reason supporting a "zero ADIT" outcome. On the contrary, a "zero-ADIT" outcome would seem to undercut the regulatory balance embedded in the Normalization Rules.

Carryover ADIT Reserve

A third possibility is that each Taxpayer's post-Asset Exchange ADIT balance should be limited to the ADIT balance associated with the replacement property prior to the Asset Exchange. Under this alternative, the result would be:

AFTER ASSET EXCHANGE		
	Midstream Assets (Owned by EQT)	Distribution Assets (Owned by LDC Funding)
BOOK VALUE	\$140 Million	\$140 Million
TAX BASIS	\$30 Million	\$100 Million
ADIT BALANCE	\$14 Million	\$39 Million

This approach has a certain logic from a regulatory perspective. Immediately after the Asset Exchange, the replacement property is used in a continuation of the trade or business conducted prior to the transaction. Because the pre-transaction ADIT balances were not triggered by the Asset Exchange, it arguably could be appropriate to maintain the savings available to each set of ratepayers based on the pre-transaction ADIT balance associated with those same assets used in the provision of service after the transaction.

However, pursuant to Code §1031, each Taxpayer has a book/tax basis difference that is computed by reference to its relinquished property, not its replacement property. If this alternative were adopted in the context of Taxpayers' Code §1031 exchange, there would be no correlation between Taxpayers' ADIT reserves and the tax bases of the assets used to provide service to ratepayers. Although each Taxpayer would effectively retain the cost-free capital produced by the relinquished property, it would reduce its rate base by an ADIT balance that represents the cost-free capital retained by its counterparty.

For example, Peoples would reflect an ADIT balance with respect to the Distribution Assets of \$39 million although it has only received the benefit of \$14 million of cost-free capital through accelerated depreciation. The imputation of a quantity of cost-free capital attributable to accelerated depreciation in excess of that actually possessed would seem to contravene the

limitations imposed by Treas. Reg. §1.167(l)-1(h)(6). By contrast, AVC would reflect an ADIT balance of \$14 million with respect to the Midstream Assets although it has received the benefit of \$39 million of cost-free capital through accelerated depreciation. While this provision of an incremental benefit related to accelerated depreciation should be permissible under the Normalization Rules, there is nothing in those rules that would suggest that this result is necessary to protect against the regulatory extraction of the benefits of accelerated depreciation.

Requested Rulings #3 and #4

If the answer to Requested Rulings #1 and #2 are affirmative, then Taxpayers must apply to their substituted ADIT balances the requirements imposed by Treas. Reg. §1.167(l)-1(h)(2)(i). This provision addresses the circumstances under which ADIT balances established pursuant to the Normalization Rules can be adjusted. There appear to be two available alternatives.

The first alternative would be to apply this requirement as if Taxpayers had not disposed of the relinquished property that produced their respective ADIT balances. For example, after the Asset Exchange, Peoples would adjust its ADIT balance associated with the Distribution Assets (its replacement property) to reflect what happens to the Midstream Assets (its relinquished property). Such an approach would be consistent with the proposition that, for purposes of the Normalization Rules, nothing has happened. However, it would require that each Taxpayer adjust its respective ADIT balance to reflect changes (*e.g.*, depreciation, retirements or other dispositions, etc.) relating to assets that it no longer owns and with respect to which it has no control and, most likely, no information. Moreover, when these changes materialize, they would not actually impact the quantity of cost-free capital that the Taxpayer has

received. They would impact the quantity of cost-free capital possessed by the new owner of the assets (*e.g.*, AVC, in respect of the Midstream Assets). Continuing the example, if AVC disposed of the Midstream Assets at some point, such disposition would not impact Peoples' level of cost-free capital.

The more logical, second alternative would be to apply the requirements of Treas. Reg. §1.167(l)-1(h)(2)(i) to the changes that impact the tax basis of each Taxpayer's replacement property in its hands, *i.e.*, as if the replacement property (and not the relinquished property) had generated the ADIT balance on its regulatory books of account. This alternative has none of the administrative issues inherent with the first alternative and, most significantly, accurately represents the level of Taxpayers' cost-free capital attributable to accelerated depreciation.

CONCLUSION

For the reasons set forth above, Taxpayers respectfully request that the Service issue the rulings requested.

PROCEDURAL MATTERS

A. Statements required by Rev. Proc. 2014-1:

1. Section 7.01(4) – To the best of the knowledge of each Taxpayer and its representative, the issue that is the subject of this ruling request is not addressed in any returns of Taxpayers, related taxpayers within the meaning of §267, members of the affiliated groups of which either Taxpayer is also a member within the meaning of §1504 or any predecessor that is currently or was previously under examination, before Appeals, or before a Federal court.

2. Section 7.01(5)(a) – To the best of the knowledge of each Taxpayer and its representative, the Service has not previously ruled on the issue that is the subject of this ruling request or a similar issue for Taxpayers, related taxpayers within the meaning of §267, or members of an affiliated group of which either Taxpayer is also a member within the meaning of §1504, or any predecessors.

3. Section 7.01(5)(b) - To the best of the knowledge of each Taxpayer and its representative, neither Taxpayers, related taxpayers, predecessors, nor any representatives previously submitted a request (including an application for change in method of accounting) involving the same or a similar issue to the Service but with respect to which no letter ruling or determination letter was issued.

4. Section 7.01(5)(c) - To the best of the knowledge of each Taxpayer and its representative, neither Taxpayers, related taxpayers, nor predecessors, previously submitted a request (including an application for change in method of accounting) involving the same or a similar issue that is currently pending with the Service.

5. Section 7.01(5)(d) – To the best of the knowledge of each Taxpayer and its representative, neither Taxpayers nor related taxpayers are presently submitting additional requests (including an application for change in method of accounting) involving the same or a similar issue.

6. Section 7.01(8) - The law in connection with this request is uncertain and the issue is not adequately addressed by relevant authorities.

7. Section 7.01(9) - Taxpayers have included all supportive as well as all contrary authorities of which they are aware.

8. Section 7.01(10) - Taxpayers are unaware of any pending legislation that may affect the proposed transaction.

9. Section 7.02(5) - Taxpayers hereby request that a copy of the ruling and any written requests for additional information be sent by facsimile transmission (in addition to being mailed) and hereby waive any disclosure violation resulting from such facsimile transmission. Please fax the ruling and any written requests to James I. Warren at (202) 626-5801.

10. Section 7.02(6) - Taxpayers respectfully request a conference on the issues involved in this ruling request in the event the Service reaches a tentatively adverse conclusion.

11. Taxpayers will permit the PPUC and the FERC to participate in any Associate office conference concerning this ruling request. Taxpayers have provided the PPUC and the FERC with a copy of this ruling request prior to its being filed and have encouraged each agency to provide their views or observations to the Service.

B. Administrative

1. The deletion statement and checklist required by Rev. Proc. 2014-1 are enclosed.
2. The required user fee of \$38,000 (\$19,000 for each Taxpayer) is enclosed.
3. Two Forms 2848 Power of Attorney granting each Taxpayer's representative the right to represent that Taxpayer is enclosed.

Associate Chief Counsel
Internal Revenue Service
Draft of July 9, 2014
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If you have any questions or need additional information regarding this ruling request, pursuant to the enclosed Powers of Attorney, please contact James I. Warren at (202) 626-5959.

Respectfully submitted,

James I. Warren
Miller & Chevalier Chartered
Attorney for LDC Funding LLC and EQT Corporation

PENALTIES OF PERJURY STATEMENT

LDC Funding LLC

Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the request contains all the relevant facts relating to the request, and such facts are true, correct, and complete.

LDC Funding LLC

BY:

Jason Francl, Vice President

DATE: _____

PENALTIES OF PERJURY STATEMENT

EQT Corporation

Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the request contains all the relevant facts relating to the request, and such facts are true, correct, and complete.

EQT Corporation

BY:

Thomas E. Quinlan, Assistant Treasurer

DATE: _____

DELETION STATEMENT

For purposes of Section 6110(c)(1) of the Internal Revenue Code of 1986, as amended, Taxpayers request the deletion of all names, addresses, EINs, locations, dates, amounts, regulatory bodies and other taxpayer identifying information contained in the attached request for private letter ruling.

Taxpayers reserve the right to review, prior to disclosure to the public, any information related to this request for private letter rulings and to provide redacted copies of any documents to be released to the public.

Date: _____

James I. Warren
Miller & Chevalier Chartered
Attorney for LDC Funding and EQT Corporation

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been served upon the following persons, in the manner indicated, in accordance with the requirements of § 1.54 (relating to service by a participant).

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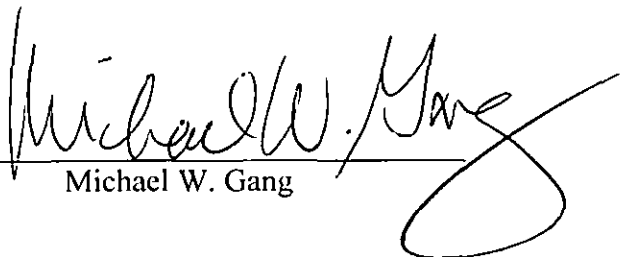
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Dated: August 11, 2014


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