

Abandonment losses

Considerations for the power and utilities industry

A new rule announced by the Environmental Protection Agency (EPA) on March 27, 2012 will limit greenhouse gas (GHG) emissions from new power plants in the United States. The rule, called the New Source Performance Standards (NSPS), presumes, in effect, that no new coal-fired power plants will be built for the foreseeable future, and so sets a carbon dioxide emission limitation based on the performance of natural gas combined cycle (NGCC) plants. The NSPS rule will effectively rule out the construction of new coal plants because none could be affordably built to meet the standard.

A federal appeals court has issued a directive to the EPA to rewrite its rule, based on their judgement that the EPA has in fact overstepped its authority by requiring power companies to reduce certain greenhouse gas levels at greater rates than what the law had intended. Because of the EPA's original ruling, a number of utility companies are considering the tax consequences of retirement or "abandonment" of existing plants, instead of undergoing expensive environmental retrofits.

What are the options?

Options for power and utility companies include selling the coal plant, converting to natural gas, temporarily idling the plant, permanently closing the plant, and even demolishing the plant.

Each of these options can have different tax consequences including whether the loss is deductible, the timing of when the loss is

allowable, and whether the loss is ordinary or capital.

Exploring temporary idle

The retirement of property means that the owner of the property will no longer be using the property going forward. A taxpayer who announces a plan to shut down a plant is not entitled to a tax benefit simply by announcing the discontinuance of a plant. In fact, retirement of property, for tax purposes, is complex in nature. Under the tax code, retirement of property means "the permanent withdrawal of property from use in the trade or business or in the production of income." Unfortunately, this definition provides little guidance on how to proceed with the retirement of property.

Thus, there may be unfavourable tax consequences of announcing that you may eventually restart a plant that you intend to close, as the IRS might look to this announcement as evidence that you did not intend to retire it.

Taking a closer look at a permanent closing

The physical abandonment of property generally requires voluntarily and permanently giving up possession and use of the property with the intention of ending ownership, but without transferring ownership on to anyone else. Even this is not completely clear, as there are multiple indications that the IRS may look to for determining whether you have permanently retired the plant. These could include:

- Whether you have terminated the plant employees
- Whether you continue to insure the plant
- Whether you have removed or disabled the plant equipment,
- And other factors

Considerations

- If the plant is abandoned, is the loss currently deductible and in what year? Is it an ordinary or a capital loss?
- To qualify for loss treatment, must the assets be actually disposed of, or reduced to a condition whereby they cannot be used, in order to be deductible for tax purposes?
- What are the triggering events for an abandonment deduction or a loss on the disposition of the assets?
- What happens if the assets are held for sale?
- What would be the tax impact if the taxpayer decides to transfer the assets into a scrap account versus discarding the assets irrevocably and thus abandoning the property?
- What are the tax implications if the abandoned property will be demolished or dismantled?
- What is the relevance of the timing of the demolition vis-à-vis the abandonment?
- What are the income tax implications for the demolition costs?

Real and personal property taxes

- Can the property taxes be reduced when the fair market value (FMV) of the property decreases for a prolonged period?
- Will the company need to file formal protests with the taxing jurisdictions to achieve this relief?

The tax implications of closing a plant can vary widely depending upon many factors, and thus it is important to thoroughly evaluate the various possibilities before deciding upon a course of action or making any sort of public announcement.

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