Madison Gas & Electric Co.
v. Commissioner
633 F.2d 512 (7th Cir. 1980)

Tenancy-In-Common of Nuclear Power Plant was a Partnership

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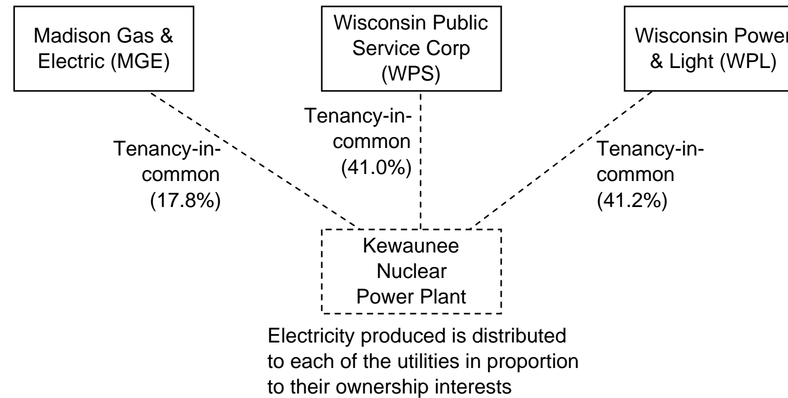

On February 2, 1967, MGE entered into an agreement, entitled "Joint Power Supply Agreement" (Agreement), with WPS and WPL under which the three utilities agreed to construct and own together a nuclear generating plant (Plant). Under the Agreement, the Plant is owned by MGE, WPS and WPL as tenants-in-common with undivided ownership interests of 17.8%, 41.2% and 41.0% respectively. Electricity produced by the Plant is distributed to each of the utilities in proportion to their ownership interests. Each utility sells or uses its share of the power as it does power produced by its own individually owned facilities. No portion of the power generated at the Plant is offered for sale by the utilities collectively. Each utility also pays a portion of all expenditures, for operation, maintenance and repair of the Plant corresponding exactly to its respective share of ownership.

In its 1969 and 1970 taxable years, MGE incurred certain expenses relating to the nuclear training of WPS employees, the establishment of internal procedures and guidelines for plant operation and maintenance, employee hiring activities, nuclear field management, environmental activities and the purchase of certain spare parts. MGE had to incur these expenses in order to carry out its Plant activities. The Tax Court held and the 7th Circuit affirmed that these expenses were non-deductible pre-operating capital expenditures of a new partnership venture.

While it is well-settled that mere co-ownership of property does not create a tax partnership, co-owners may also be partners if they or their agents carry on the requisite "degree of business activities." The definition of partnership in Section 7701(a)(2) was added to the Code by the Revenue Act of 1932. The Congressional Reports accompanying the 1932 Act make clear, in largely identical language, that Congress intended to broaden the definition of partnership for federal tax purposes to include a number of arrangements, such as joint ventures, which were not partnerships under state law. In Bentex Oil Corp. v. Commissioner, 20 T. C. 565 (1953), the Tax Court held that an unincorporated organization formed to extract oil under an operating agreement which called for distribution of oil in kind was a partnership. The Bentex joint venture is not distinguishable. The co-owners in Bentex and in this case shared the expenses of production but sold their shares of the production individually.

Section 761(a) allows unincorporated associations such as the Bentex venture, which fall within the statutory definition of partnership, to elect out of Subchapter K. The Section has generally been interpreted, in the absence of any legislative history, as approving the Bentex decision while providing relief from certain resulting hardships. The three utilities in fact did file a partnership return and election-out of Subchapter K. Section 7701(a)(2) explicitly states that an organization which is a partnership as defined in that Section is a partnership for the purposes of the entire Code, whereas Section 761(a) provides only for election-out of Subchapter K.

The fact that the profits are not realized in cash until after the electricity has been channeled through the individual facilities of each participant does not negate their joint profit motive nor make the venture a mere expense-sharing arrangement. The Court held that MGE's joint venture with WPS and WPL constituted a partnership within the meaning of Section 7701(a)(2) and 761(a) of the Code.

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