Lead Service Lines/Drinking Water: Internal Revenue Service Determination Addressing Exemption of Replacement Cost

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The United States Internal Revenue Service ("IRS") addressed the federal income tax treatment of certain lead service line replacement programs for residential property owners. See announcement 2024-10.

The IRS determination concludes that a government subsidized project to replace the private portion of a lead service line does not result in income to the residential property owners.

The rate of replacement of lead service lines will likely increase exponentially over the next decade because of a United States Environmental Protection Agency ("EPA") proposed Safe Drinking Water Act rule denominated the Lead and Copper Rule ("LCR") improvements. The EPA have announced the rule on November 30, 2023, and while aspects of it may change when finalized, there will nevertheless be an impetus for lead service line replacement.

The United States has an estimated 9.2 million service lines which may be replaced. The current proposal has an objective of achieving 100% lead pipe replacement within 10 years.

Funding for the replacement of at least a portion of these lead service lines is provided by the Infrastructure Investments and Jobs Act. However, a potential impediment to state and local governments use of such funds was the uncertain tax status of lead pipe replacement projects. As a result, a bipartisan group of United States Senators has requested that the Internal Revenue Service clarify the tax status of lead pipe replacement grants as soon as possible.

The IRS determination by way of background notes that a lead service line is defined in the Safe Drinking Water Act regulations as a pipe and its fittings which are not lead-free. See 40 CFR 141.2. They connect a drinking water main to a building inlet. A lead service line can be owned by the following:

- Public water system
- Property owner
- Jointly owned by a public waters system and property owner

The portion of the lead service line on public property will run from the water main to the boundary of the residential property. The portion on the residential property runs from the residential property's boundary to the house or building. The federal government and many state governments require that the privately-owned portion of the lead service line be replaced simultaneously with the other relevant parts of the water system containing lead.

The IRS determination described two typical ways in which governmental entities replaced lead service lines with no cost to property owners:

- Public water system uses its own workers/contractors to replace the public portion and private portion simultaneously, controlling the timing a scope of work that is performed
- Public water system reimburses residential property owners or directly pays contractors on the residential property owners' behalf to replace the privately owned portion of lead service lines

Both methods of lead service line replacement are addressed by the IRS determination. It states in part:

… while there are factual variations, the Treasury Department and the IRS have determined that these variations do not warrant a different outcome under the federal tax laws. Accordingly, the replacement of lead service lines under the programs described above do not result in income to the residential property owners under §61 of the Internal Revenue Code.

Further, water systems in state government are not required to file information returns or furnish payee statements with respect to the replacement of lead service lines under these programs.

A copy of the IRS determination can be downloaded here.