

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

APPLICATION OF PUBLIC SERVICE)
COMPANY OF OKLAHOMA, AN)
OKLAHOMA CORPORATION, FOR AN)
ADJUSTMENT IN ITS RATES AND)
CHARGES AND THE ELECTRIC SERVICE)
RULES, REGULATIONS AND)
CONDITIONS OF SERVICE FOR)
ELECTRIC SERVICE IN THE STATE OF)
OKLAHOMA)

CAUSE NO. PUD 202100055



DIRECT TESTIMONY OF

DAVID A. HODGSON

ON BEHALF OF

PUBLIC SERVICE COMPANY OF OKLAHOMA

APRIL 2021

TESTIMONY INDEX

<u>SECTION</u>	<u>PAGE</u>
I. INTRODUCTION	1
II. PURPOSE OF TESTIMONY	2
III. SUMMARY	2
IV. ACCOUNTING FOR INCOME TAXES	3
V. NORMALIZATION OF NET OPERATING LOSSES AND ITC	7
VI. SEPARATE RETURN ACCOUNTING.....	13
VII. TAXES INCLUDED IN REQUESTED RATES	18
VIII. CONCLUSION	21

EXHIBITS

<u>EXHIBIT</u>	<u>DESCRIPTION</u>
EXHIBIT DAH-1	IRS Private Letter Ruling 201436037
EXHIBIT DAH-2	IRS Private Letter Ruling 201438003
EXHIBIT DAH-3	IRS Private Letter Ruling 201519021
EXHIBIT DAH-4	IRS Private Letter Ruling 201534001
EXHIBIT DAH-5	IRS Private Letter Ruling 201548017
EXHIBIT DAH-6	IRS Private Letter Ruling 201709008
EXHIBIT DAH-7	IRS Private Letter Ruling 202010002
EXHIBIT DAH-8	Journal Entries Associated with Pro Forma NOL Adjustment

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS.

A. My name is David A. Hodgson. I am a Tax Accounting & Regulatory Support Manager for American Electric Power Service Corporation (AEPSC), a wholly owned subsidiary of American Electric Power Company, Inc. (AEP). My business address is American Electric Power, 1 Riverside Plaza, Columbus, Ohio 43215.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A. I graduated from The Ohio State University with a Bachelor of Science in Business Administration in Accounting. In 2000, I accepted a position with AEPSC as a Tax Analyst V. I was promoted to positions from Tax Analyst IV to Tax Analyst I over the course of 2002–2009. In 2011, I was promoted to Sr. Tax Analyst, then to Tax Project Manager, and in 2013, to Tax Manager. I was promoted to my current position in 2019. As Tax Accounting & Regulatory Support Manager, I participate in the recording of the tax accounting entries and records and the review of federal and state tax returns of AEP and its subsidiaries. I am also responsible for coordinating and developing state and federal tax data provided by the AEPSC Tax Department for use in regulatory proceedings. I have attended numerous tax, accounting, and regulatory seminars throughout my professional career.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN A REGULATORY PROCEEDING?

A. Yes. I have filed testimony before the Public Utility Commission of Texas and the Louisiana Public Service commission on behalf of Southwestern Electric Power Company.

1
2 II. PURPOSE OF TESTIMONY

3 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

4 A. The purpose of my testimony is to present and sponsor the income tax expense included in
5 the cost of service and the accumulated deferred income taxes (ADIT) included in rate base
6 for the Company. I sponsor Schedules J-1 through J-3 and all supporting workpapers.
7

8 III. SUMMARY

9 Q. WHAT IS THE SOURCE OF INFORMATION USED FOR THE PREPARATION OF
10 THE TAX SCHEDULES INCLUDED IN THIS RATE FILING?

11 A. All amounts included in the tax schedules for this rate filing are taken from the books and
12 records of the Company.

13 Q. WHAT IS THE TEST YEAR FOR WHICH THE TAX SCHEDULES ARE PROVIDED?

14 A. All amounts in the schedules are shown for the historical test year with adjustments for the
15 12-month period ended December 31, 2020.

16 Q. WHAT IS THE AMOUNT OF FEDERAL AND STATE INCOME TAX EXPENSE THE
17 COMPANY IS REQUESTING TO BE INCLUDED IN THE COST OF SERVICE?

18 A. The Company is requesting the amount of federal and state income tax expense that is
19 included in the cost of service on Schedule H. This amount is supported by Schedule J-1
20 and J-2.

21 Q. WHAT IS THE AMOUNT OF ADIT THAT THE COMPANY IS REQUESTING TO BE
22 INCLUDED AS A REDUCTION TO RATE BASE?

23 A. The Company is requesting the amount of ADIT to be included as a reduction to rate base
24 as presented on Schedule B-02. This amount is supported by Schedule J-3.

1
2 IV. ACCOUNTING FOR INCOME TAXES

3 Q. WHAT TAX ACCOUNTING METHODOLOGY IS USED IN THE DETERMINATION
4 OF THE INCOME TAX EXPENSE REQUESTED IN THIS CASE?

5 A. The federal and state income tax expense as presented in this case is calculated using the
6 normalized method of tax accounting. This is consistent with the methodology used to
7 determine the tax expense included in cost of service in prior filings the Company has made
8 with the Oklahoma Corporation Commission (Commission).

9 Q. PLEASE DESCRIBE NORMALIZED INCOME TAX ACCOUNTING.

10 A. Accounting Standards Codification (ASC) 740 covers how companies should both account
11 for and report taxes based on income. The two basic objectives of ASC 740 are to recognize
12 both the amount of taxes that are either payable or refundable for the current tax year as
13 well as to recognize the deferred tax assets and liabilities for the future tax consequences
14 that have been recognized in a company's financial statements.

15 The accounting for income taxes called for by ASC 740 is known as normalized
16 income tax accounting. Normalization accounting for income taxes calculates income tax
17 expense on the pre-tax items of income and expense recorded for financial statement
18 purposes or included in the cost of service for ratemaking purposes. The income tax expense
19 is then adjusted for permanent differences between income recorded for financial reporting
20 (book) purposes and income determined for income tax reporting (tax) purposes. Tax
21 expense is then divided between the amount currently payable to the IRS and the amount
22 that must be paid in the future. This division between current and deferred tax expense is
23 calculated based on certain temporary differences between book and taxable income. The

1 tax expense incurred in the current year for which payment is deferred due to temporary
2 book/tax differences is recorded on the balance sheet as an ADIT liability or asset,
3 whichever the case may be.

4 Q. IN YOUR DESCRIPTION OF NORMALIZED TAX ACCOUNTING, YOU DISCUSS
5 TEMPORARY DIFFERENCES. CAN YOU PLEASE EXPLAIN THIS CONCEPT?

6 A. Yes. A temporary difference is a difference in the timing of recognition of an item of book
7 income and taxable income that occurs in one year and reverses in another. A temporary
8 difference does not change the overall income tax expense payable over the life of the
9 underlying timing difference; it simply affects the timing of the payment of a liability.
10 Under the normalized tax accounting method, such temporary differences do not have an
11 impact on the overall tax expense for the period.

12 An example of a temporary difference and one that is generally the largest in
13 magnitude for a public utility company results from the use of accelerated depreciation for
14 tax purposes. While depreciation of an asset can only equal the cost of the asset and can
15 only be recognized over the life of the asset, a temporary difference can occur when there
16 are differing depreciation methods. For tax purposes, accelerated tax depreciation may be
17 taken, whereas for book purposes the depreciation expense recognized for that same asset
18 is calculated using the straight-line method. Over the life of the asset, the same total amount
19 of depreciation will be recognized. However, under the accelerated depreciation method
20 used for tax purposes, those deductions will be recognized to a greater extent in the earlier
21 years of the asset's life as compared to the straight-line method. This results in taxable
22 income that is lower in the earlier years. As the straight-line depreciation begins to exceed
23 the accelerated depreciation in the later years, it results in a taxable income that is higher

1 than book income. Over the life of the asset, the amount of depreciation deducted from
2 income for both book and tax will be the same and the only impact will be the period in
3 which the deductions are recognized.

4 Q. WHAT ARE PERMANENT DIFFERENCES AND HOW DO THEY DIFFER FROM
5 TEMPORARY DIFFERENCES?

6 A. As described in my testimony, a temporary difference results only in a change in the period
7 in which an item of income or expense is recognized for book and tax. A permanent
8 difference is an item of income or expense that will never be recognized for either book
9 income or for taxable income. These differences arise due to the different rules that pertain
10 to book accounting and the tax law. Because it is an item that will never be recognized for
11 one or the other, it results in a difference that will not reverse over time as in the case of a
12 temporary difference.

13 An example of a permanent difference are entertainment expenses. For book
14 purposes, these expenses are generally recognized and reduce the overall net income of the
15 company. However, for tax purposes entertainment expenses are not allowed as a deduction
16 from income. The difference between the book deduction and the tax deduction for these
17 expenses is one that will never reverse even over the course of time. Therefore, tax expense
18 must be increased by the tax on the non-deductible amount of these expenses.

19 Q. YOU MENTIONED THAT TEMPORARY BOOK/TAX DIFFERENCES ARE
20 RECORDED ON THE BALANCE SHEET AS AN ADIT LIABILITY OR ASSET. WILL
21 YOU PLEASE PROVIDE AN EXAMPLE OF HOW ADIT BALANCE ACCRUES?

1 A. Yes. Imagine a utility had a taxable income of \$1,000 and a federal income tax rate of 21%.
2 Absent any other factors, the utility would collect \$210 from its customers as federal income
3 tax expense, and it would pay the Internal Revenue Service \$210 in federal income taxes.

4 Now suppose the same set of facts, except that the utility has used accelerated
5 depreciation to offset all of its \$1,000 income. Because of normalization rules, the utility
6 still collects \$210 from its customers, but because of the temporary timing difference, the
7 utility will not have to pay that \$210 to the IRS until some later date when the utility has
8 taxable income. In effect, the utility is given a \$210 interest-free loan from the federal
9 government, but the utility must record that interest-free loan as an ADIT liability.

10 Q. HOW DOES THE ADIT BALANCE AFFECT A UTILITY'S RATES?

11 A. Until the ADIT balance is paid back to the Internal Revenue Service, it is used as a dollar-
12 for-dollar reduction of rate base.

13 Q. PLEASE EXPLAIN WHAT NORMALIZATION TAX ACCOUNTING MEANS IN THE
14 CONTEXT OF A PUBLIC UTILITY COMPANY.

15 A. For a public utility company, normalization is a method of accounting in which the tax
16 benefits of accelerated depreciation on public utility assets are shared with customers ratably
17 over the regulatory useful life of the assets in the form of reduced rates.

18 Q. CAN YOU EXPLAIN FLOW-THROUGH TAX ACCOUNTING AND HOW THAT
19 DIFFERS FROM NORMALIZED TAX ACCOUNTING?

20 A. The flow-through method of tax accounting looks only at the amount of taxes that are
21 payable or refundable for the current tax year and does not recognize the future benefit or
22 detriment of temporary differences in income recorded for book purposes and income
23 determined for tax purposes. This method treats any temporary difference as a permanent

1 increase or decrease in the income taxes for the period depending on the direction of the
2 temporary difference. This method results in benefits and detriments being allocated among
3 customers in different periods depending on when a temporary difference originates and
4 reverses. For example, a timing difference that results in a deduction in Year 1 would be
5 enjoyed by the set of customers of the company in Year 1 as a reduction to the current year
6 taxes payable. However, if this timing difference were to reverse in Year 2, the detriment
7 of the increase to the current year taxes payable would be borne by the set of customers of
8 the company in Year 2, which, of course, is not necessarily the same set of customers as in
9 Year 1. As the flow-through method only recognizes the current tax payable or receivable
10 and ignores the impact of future tax impacts from timing differences, there is no deferred
11 tax expense and as a result no ADIT that would be provided as a reduction to rate base.

13 V. NORMALIZATION OF NET OPERATING LOSSES AND ITC

14 Q. WHAT IS A NET OPERATING LOSS?

15 A. A net operating loss (NOL) occurs when, in a given year, a taxpayer has more deductions
16 than taxable revenues. When an NOL occurs, the Internal Revenue Code (Code) allows the
17 taxpayer to carry the NOL forward to subsequent years and offset otherwise taxable income
18 produced in that future year.

19 Q. ARE THERE NORMALIZATION REQUIREMENTS INCLUDED WITHIN THE
20 CODE?

21 A. Yes. The Code and accompanying treasury regulations provide normalization requirements
22 and specifically in three areas: 1) Accelerated depreciation and the associated deferred tax

1 liability that results from its use; 2) NOL Carryforwards (NOLC) as a result of accelerated
2 depreciation; and 3) Investment Tax Credits (ITC).

3 Q. CAN YOU PLEASE DISCUSS THE NORMALIZATION REQUIREMENTS IN THE
4 CODE AS IT RELATES TO ACCELERATED DEPRECIATION?

5 A. The Code dictates that a regulated public utility must use the normalization method of
6 accounting to calculate tax expense on temporary differences associated with accelerated
7 depreciation when determining rates using a cost of service/rate of return methodology. 26
8 U.S. Code §168(i)(9)(A) states that in order for a public utility to be considered to be using
9 a normalized method of accounting:

10 (i) the taxpayer must, in computing its tax expense for purposes of
11 establishing its cost of service for ratemaking purposes and reflecting
12 operating results in its regulated books of account, use a method of
13 depreciation with respect to such property that is the same as, and a
14 depreciation period for such property that is no shorter than, the method and
15 period used to compute its depreciation expense for such purposes, and
16 (ii) if the amount allowable as a deduction under this section with respect to
17 such property (respecting all elections made by the taxpayer under this
18 section) differs from the amount that would be allowable as a deduction
19 under section 167 using the method (including the period, first and last year
20 convention, and salvage value) used to compute regulated tax expense under
21 clause (i), the taxpayer must make adjustments to a reserve to reflect the
22 deferral of taxes resulting from such difference¹.

23 Q. CAN YOU PLEASE DISCUSS THE NORMALIZATION REQUIREMENTS AS THEY
24 RELATE TO NOLC?

25 A. This is specifically addressed in Treasury Regulation § 1.167(l)-1(h)(1)(iii), which states:

26 If, however, in respect of any taxable year the use of a method of depreciation
27 other than a subsection (l) method for purposes of determining the taxpayer's
28 reasonable allowance under section 167(a) results in a net operating loss
29 carryover (as determined under section 172) to a year succeeding such
30 taxable year which would not have arisen (or an increase in such carryover
31 which would not have arisen) had the taxpayer determined his reasonable
32 allowance under section 167(a) using a subsection (l) method, then the

¹ 26 U.S.C. § 168(i)(9)(A).

1 amount and time of the deferral of tax liability shall be taken into account in
2 such appropriate time and manner as is satisfactory to the district director.

3 Although neither the Code nor the regulations specifically address the manner in
4 which the NOL should be treated in ratemaking under the normalization rules, the
5 IRS has addressed this issue in several private letter rulings (PLRs). PLRs
6 201436037, 21438003, 201519021, 201534001, 201548017, 201709008, and
7 202010002 clarify that a tax calculation with and without accelerated depreciation
8 is used to determine the amount of the NOLC accumulated deferred federal income
9 tax (ADFIT) required to be normalized.² To the extent that accelerated depreciation
10 creates an NOLC, the NOLC ADFIT must be a component of rate base. This can
11 be reflected in rate base through ADFIT using either one of two methods to adhere
12 to the normalization rules. In the first method, the deferred tax liability that is a
13 result of accelerated depreciation would simply be reduced by the amount of the
14 NOLC ADFIT. In the second method, the full, deferred tax liability is included as
15 a rate base reduction and a separate deferred tax asset in the amount of the NOLC
16 ADFIT is included as a rate base increase. The result of both is the same; the impact
17 on rate base includes the net balance of the ADFIT for accelerated depreciation and
18 the ADFIT for the NOLC. The PLRs uniformly conclude that excluding the NOLC
19 ADFIT would constitute a normalization violation.

20 Q. WHAT IS THE RATIONALE FOR THIS TREATMENT OF THE NOLC ADFIT?

21 A. When a regulated utility experiences a NOLC, the taxpayer has not yet received the benefit
22 of the depreciation-related ADFIT, i.e., there is no interest free loan from the federal

² The PLRs are included as Exhibits DAH-1 – DAH-7 to my direct testimony.

government. Accordingly, the rate base reduction is deferred until the NOLC is utilized and the loan is extended.

Q. PLEASE DESCRIBE THE CONCLUSIONS IN THE PLRS MENTIONED ABOVE.

A. The PLRs mentioned above confirm that NOLC ADFIT must be included in rate base to avoid a normalization violation. They describe the NOLC as a necessary reduction to the rate base impact of the deferred tax liability associated with accelerated depreciation. Further, the PLRs prescribe either one of two approaches for determining the amount of the NOLC ADFIT that must be included in rate base: a “with-and-without” or “last dollar deducted” approach. Both of these approaches look at the hypothetical taxable income of the utility without the deductions for accelerated depreciation. The extent to which an NOLC is then attributable to accelerated depreciation must be included in rate base to avoid a normalization violation. The PLRs all contain language very similar to the following:

Because the [ADFIT] account [Account 282], the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes [(ADFIT)]...

The “with or without” [or “last dollar deducted”] methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of “flow through” of the benefits of accelerated depreciation to ratepayers³

Q. IS THE INCLUSION OF AN NOLC IN RATE BASE ALSO A SOUND ACCOUNTING AND REGULATORY PRACTICE?

A. Yes. The normalization treatment of an NOLC assures that the customers of a utility receive the benefit of the deferred tax payment associated with accelerated depreciation no sooner

³ Bracketed entry added for clarity.

1 than they would be able to do so based on the operations of the utility as an entity that files
2 a separate return. This lines up the timing of customer benefits with the ability of the utility
3 operations to provide those benefits.

4 Q. ARE THERE REPERCUSSIONS TO NOT FOLLOWING THE NORMALIZATION
5 REQUIREMENTS FOR ACCELERATED DEPRECIATION?

6 A. Yes. A depreciation-related normalization violation results in the utility no longer being
7 allowed to use accelerated depreciation on all property used to provide regulated service to
8 the jurisdiction in which the violation occurred.⁴ In addition, the taxes that have been
9 deferred as a result of the prior accelerated depreciation must be paid to the federal
10 government more quickly than they would be in the absence of the violation.

11 Q. WHAT IMPACT WOULD A NORMALIZATION VIOLATION HAVE ON
12 CUSTOMERS?

13 A. A normalization violation would be harmful to customers as it would result in higher utility
14 rates. As noted above, a normalization violation would prevent the utility from claiming
15 deductions for accelerated depreciation and would result in the company paying the IRS
16 more rapidly for the previously deferred taxes. This would result in a lower ADIT balance
17 which would cause the rate base for the company to increase. As customers pay a return on
18 rate base, any increase in rate base would directly result in higher rates. This lower ADIT
19 would represent the reduction to a cost-free source of capital for the company.

20 Q. CAN YOU PLEASE DISCUSS THE NORMALIZATION REQUIREMENTS AS THEY
21 RELATE TO ITC?

⁴ 26 U.S.C. § 168(f)(2).

1 A. The normalization rules as they relate to ITC require that the benefit of ITC cannot be passed
2 to customers any faster than ratably over the book depreciable life of the underlying assets
3 that generated the ITC. As such, a utility is unable to provide the benefits of the ITC to
4 customers either at the time in which the credit is generated or at the time in which the credit
5 is utilized and reduces the tax liability of the utility. A utility may elect to pass the benefit
6 of ITC to customers through one of two methods as directed by §46(f)(1) and §46(f)(2).
7 Under §46(f)(1), a utility passes the benefit of the ITC through a reduction to rate base,
8 provided that the reduction is restored not less rapidly than ratably. No adjustment may be
9 made to cost of service on account of the ITC. Under §46(f)(2), a utility shares the benefit
10 of the ITC with customers by amortizing the benefit in the cost of service no more rapidly
11 than ratably over the book life of the property generating the credit. No reduction to rate
12 base is permissible under this method.

13 Q. WHAT METHOD HAS THE COMPANY ELECTED TO PASS THE BENEFITS OF ITC
14 TO CUSTOMERS?

15 A. The Company elected to pass the benefits of ITC to customers using the method allowed
16 under §46(f)(2). The cost of service includes a deferred tax benefit resulting from the
17 amortization of ITC. This deferred tax benefit is specifically identified on Schedule J-1.

18 Q. WHAT IS THE PENALTY FOR AN ITC NORMALIZATION VIOLATION?

19 A. In the case of an ITC normalization violation, a utility would have to refund to the IRS the
20 balance of the unamortized ITC at the time the violation occurred. This would eliminate
21 the future benefit to customers of any reduction to rates through either a cost of service or
22 rate base reduction.

23

1 VI. SEPARATE RETURN ACCOUNTING

2 Q. WHAT IS MEANT BY A “SEPARATE RETURN” APPROACH TO CALCULATING
3 INCOME TAXES?

4 A. The “separate return” methodology calculates income taxes on utility revenues and
5 expenses that are included in the utility’s revenue requirement. This approach appropriately
6 allocates income taxes between customers and shareholders using a benefits/burdens
7 criteria. Under this methodology, income tax expense relates to, and results from, the
8 provision of utility service to customers. Additionally, the “separate return” income tax
9 calculation includes an adjustment to synchronize interest. Synchronized interest represents
10 the portion of return that is deductible for tax purposes, and it is calculated by multiplying
11 the weighted cost of debt by rate base. Use of synchronized interest in the tax calculation
12 effectively “synchronizes” the calculation of income tax expense with rate base and rate of
13 return. It calculates income taxes consistent with the assumptions used to calculate rate base
14 and the rate of return. Synchronized interest may be more or less than the actual interest
15 deducted on the tax return.

16 Q. DO THE TAXES REQUESTED IN THIS CASE REPRESENT A SEPARATE RETURN
17 APPROACH?

18 A. Yes, the tax expense and ADIT included in this case represents the tax associated only with
19 the income and expense of the Company in providing utility service to customers. It does
20 not include any benefits or detriments that may arise from being included in a consolidated
21 tax return.

22 Q. WHY IS THE “SEPARATE RETURN” APPROACH THE PROPER METHODOLOGY
23 TO USE IN CALCULATING INCOME TAXES FOR RATEMAKING PURPOSES?

1 A. The “separate return” approach includes in the cost of service only income taxes that result
2 from the provision of utility service to customer. Income taxes requested by the Company
3 are based on revenues and expenses included in the cost of service calculation. There are
4 no additions to or reductions from tax expense resulting from revenues or expenses not
5 included in the Company’s request. It is neither appropriate nor equitable to increase or
6 reduce cost of service by tax costs or benefits that are not related to the rendition of utility
7 service to customers. The use of a separate return approach prevents the cross-subsidization
8 of costs or benefits among affiliate companies. Normalization requires consistency among
9 tax expense, book depreciation expense, rate base, and the deferred tax reserve.⁵

10 Q. IS THE REQUEST FOR TAXES ON A SEPARATE RETURN BASIS CONSISTENT
11 WITH THE TAXES REQUESTED IN THE COMPANY’S MOST RECENT BASE
12 CASE?

13 A. The request for taxes on separate return basis is consistent with the Company’s most recent
14 base case but for the treatment of NOL and tax credit carryforwards. In Cause No. PUD
15 201800097, the Company presented taxes on a separate return basis for all tax expense and
16 ADFIT items but for NOL and tax credit carryforwards. The NOL and tax credit
17 carryforwards presented in that case reflected adjustments to the ADIT balance for the
18 utilization of those tax attributes as a result of the Company being a member of a
19 consolidated group for its federal tax return.

20 Q. WHY HAS THE COMPANY PRESENTED NOL AND CREDIT CARRYFORWARDS
21 ON A SEPARATE RETURN BASIS FOR THIS FILING?

⁵ 26 U.S.C. § 168(i)(9)(B).

1 A. The Company has presented the NOL and tax credit carryforwards on a separate return basis
2 because it is the proper method to calculate income taxes for ratemaking purposes for the
3 reasons discussed above.

4 During the preparation for this filing, the Company identified a risk that it faced if
5 the NOL was not presented on a separate return basis. In instances, such as this, in which a
6 member of a consolidated group is in an NOL position as determined on a separate return
7 basis and the NOL is the result of accelerated tax depreciation, there is a risk that the
8 Company would not be adhering to the consistency requirement of the normalization rules.
9 Tax expense included in rates is calculated only using the revenue and expenses associated
10 with providing utility service to the Company's customers. Similarly, book depreciation is
11 based only on the assets that are used to provide utility service to customers. If the NOL
12 carryforward were not calculated on a separate return basis, then the ADIT included in rate
13 base would reflect a reduction that is directly a result of the taxable situation of affiliate
14 companies. This would result in a rate base that is inconsistent with tax expense and book
15 depreciation and therefore not in compliance with the normalization rules.

16 Q. PLEASE EXPLAIN WHY THE BOOKS OF THE COMPANY DO NOT REFLECT THE
17 NOL CARRYFORWARD ON A SEPARATE RETURN BASIS?

18 A. The balance reflected on the books of the Company are a result of its participation in a
19 consolidated return with its parent company and affiliates (consolidated return group). As
20 part of the consolidated return group, the Company also participates in the group's tax
21 allocation agreement (agreement). The agreement dictates the allocation of the consolidated
22 tax liability and tax attributes among members of the group. As a result of the agreement,
23 the books of the Company reflect an NOL carryforward only to the extent that the

1 consolidated return group has a carryforward and only for the Company's allocated share
2 of that carryforward. At the end of the test year, the consolidated return group was not
3 expecting to have an NOL carryforward. As a result, the Company did not have an NOL
4 carryforward on its books despite the fact that it has an NOL carryforward when calculated
5 on a separate return basis.

6 Q. DOES THE PARTICIPATION IN THE TAX SHARING AGREEMENT MEAN THAT
7 THE COMPANY RECEIVED PAYMENTS FOR ITS NOL CARRYFORWARDS?

8 A. Yes, it has. The tax sharing agreement directs companies with taxable income to remit a
9 payment to the parent company of the consolidated return group in the amount of its tax
10 liability. To the extent that there are companies with taxable losses, the parent company
11 will distribute payments to those companies for the difference between the amount the
12 parent company is required to remit to the IRS and the amount it received from taxable
13 income companies. Through this intercompany payment process, the Company has
14 received payments for use of its NOL carryforwards.

15 Q. IF THE COMPANY RECEIVED PAYMENTS FOR ITS NOL CARRYFORWARDS
16 THEN WHY SHOULD THE SEPARATE RETURN NOL CARRYFOWARD BE
17 INCLUDED IN RATE BASE?

18 A. The separate return NOL carryforward is both appropriate and necessary to include in the
19 net ADIT reduction to rate base. First, the IRS guidance and the Code both indicate that a
20 NOL carryforward as a result of accelerated depreciation must be included in the rate base
21 of the utility. As discussed, the IRS has issued numerous PLR's all indicating that in order
22 to comply with the normalization rules of the Code, the NOL carryforward must be a

component of rate base. The normalization rules of the Code also specify that the assumptions for tax expense, book depreciation, and rate base must be consistent.

Below is a simple example of a company that has accelerated tax depreciation deductions greater than its pre-tax book income which results in an NOL. In the example, \$2,100 is included in the cost of service for tax expense. The \$14,000 deduction for accelerated depreciation results in a deferred tax liability of (\$2,940). The company in this example has generated an NOL of \$4,000 which results in a deferred tax asset of \$840. As you can see in the example, when the deferred tax liability is netted with the NOL deferred tax asset the result is a rate base reduction of (\$2,100). This rate base reduction is equal to the tax expense customers have paid for in the cost of service. If, however, the NOL deferred tax asset is not included as a component of rate base then rate base is reduced by (\$2,940), an amount greater than the tax expense included in the cost of service. That difference between tax expense and rate base exemplifies the need for the NOL carryforward to be included as a component of rate base in order to comply with the consistency requirement of the normalization rules.

Income Tax Expense - Per Income Statement

Pre-Tax Net Income	10,000
Statutory Tax Rate	21%
Total Tax Expense	<u>2,100</u> (Tax Expense collected in customer rates)

	Taxable Income		Tax Rate	(DTL) / DTA
Pre-Tax Net Income	10,000			
Accelerated Tax Depreciation Reducing Income to Zero	(14,000)	x	21%	<u>(2,940)</u>
				(2,940) ADIT Rate Base Reduction w/o NOL
Taxable Income (Loss)	<u>(4,000)</u>			
Net Tax Loss Carry Forward	4,000	x	21%	<u>840</u>
				(2,100) ADIT Rate Base Reduction with NOL

VII. TAXES INCLUDED IN REQUESTED RATES

Q. WHAT LEVEL OF INCOME TAX EXPENSE IS INCLUDED IN THE TOTAL COMPANY PRO FORMA COST OF SERVICE?

A. The Total Company pro forma cost of service includes an income tax benefit of \$3,457,547. The operating income before income taxes is reduced by the interest synchronization adjustment to arrive at a pre-tax book income of (\$9,238,235). After making adjustments to the pre-tax book income for permanent and flow-through Schedule M adjustments, the adjusted book income is multiplied by the overall income tax rate of 25.4717% to arrive at an income tax benefit of \$461,598. This income tax benefit is then adjusted to include the amortization of federal and state ITC's to arrive at the final income tax expense (benefit).

Q. CAN YOU DESCRIBE THE INTEREST SYNCHRONIZATION ADJUSTMENT?

A. Yes. The interest synchronization adjustment represents the portion of the return on rate base that is deductible for tax purposes. It is calculated by multiplying the weighted cost of debt by rate base. The use of this synchronized interest in the tax calculation effectively "synchronizes" the calculation of income tax expense with rate base and the rate of return. It calculates income taxes consistent with the assumptions used to calculate rate base and the rate of return. Synchronized interest may be more or less than the actual interest deducted on the tax return.

Q. CAN YOU DESCRIBE HOW YOU CALCULATED THE OVERALL INCOME TAX RATE OF 25.4717% THAT YOU USED IN ARRIVING AT THE INCOME TAX EXPENSE REQUESTED?

A. Yes. The overall income tax rate of 25.4717% factors in both the federal and state income tax rate as well as the deductibility of state income tax expense in the calculation of

Oklahoma state income taxes. The federal income tax rate of 21% is added to the Oklahoma state income tax rate of 6% for a total of 27%. This is then dampened by the deductibility of state income taxes by dividing the 27% rate by 1.06 (1 + Oklahoma tax rate).

Q. DOES THE TAX EXPENSE REQUESTED BY THE COMPANY INCLUDE AN AMORTIZATION OF EXCESS ADFIT?

A. No. A proforma adjustment was made to the test year income tax expense to remove the impact of the amortization of excess ADFIT. The Company passes back the benefit of excess ADFIT amortization to customers through the Tax Cut and Jobs Act of 2017 Adjustment Rider. Because the amortization is included in that rider, it is not necessary or correct to include as a part of the tax expense requested in this filing.

Q. CAN YOU DISCUSS THE PRO FORMA ADJUSTMENT TO THE FEDERAL ITC AMORTIZATION?

A. Yes. As previously mentioned, under §46(f)(2), a utility shares the benefit of the ITC with customers by amortizing the benefit in the cost of service no more rapidly than ratably over the book life of the property generating the credit. The Company has proposed to increase book depreciation rates in its request for new base rates. The level of ITC amortization in the tax expense requested in the cost of service reflects the expected level of amortization with the requested book depreciation rates.

Q. CAN YOU DISCUSS THE TYPES OF PRO FORMA ADJUSTMENTS THAT WERE MADE TO THE ADIT INCLUDED AS A REDUCTION TO RATE BASE?

A. Yes. Three types of pro forma adjustments were made to arrive at the requested level of ADIT to be included as a reduction to rate base: 1) adjustments to exclude ADIT balances which relate to book accounts that are not included in the Company's requested rate base;

2) adjustments to include the tax effects of other pro forma adjustments to rate base; 3) adjustments to reflect ADIT on a separate return accounting basis.

Q. CAN YOU DISCUSS THE PRO FORMA ADJUSTMENTS MADE TO REFLECT ADIT ON A SEPARATE RETURN ACCOUNTING BASIS?

A. Yes. A pro forma adjustment of \$154,832,586 is being made to reduce the ADIT balance for a federal NOL calculated on a separate return basis. This adjustment represents the amount of ADIT associated with accelerated tax depreciation which has not been able to produce cash benefits to the company on the basis of a separate tax return method as of the end of the historic test year. This adjustment reflects the ADIT associated with the taxable losses the Company has generated in excess of the taxable income it has generated and been able to offset based on the NOLC and carryback provisions of the Code.

Q. WAS A “WITH-AND-WITHOUT” ANALYSIS DONE TO DETERMINE THE AMOUNT OF NOL SUBJECT TO THE REQUIREMENTS OF NORMALIZATION?

A. Yes. A “with-and-without” calculation was performed to determine the amount of the NOL required to reduce the ADIT balance. This calculation determined that all of the \$154,832,586 NOLC is a result of accelerated tax depreciation and therefore subject to the normalization rules as described previously in my testimony.

Q. WHY IS IT APPROPRIATE TO INCLUDE THIS NOL CARRYFORWARD IN RATE BASE?

A. It is appropriate to include the NOLC as a decrease to the ADIT balance because it represents the level of cost free capital to which the Company had access based on its utility operations on a separate return basis. It is also appropriate due to the normalization rules discussed earlier in my testimony. Deductions for accelerated depreciation result in cash

1 benefits through a deferral of taxes payable to the government. This adjustment aligns the
2 timing of these cash benefits to customers with the timing of the cash benefits that would
3 be received by the Company if it had filed a separate return. The inclusion of the NOL
4 offsets the rate base reduction associated with deferred tax liabilities for accelerated
5 depreciation for which the Company would not yet receive a cash benefit for on a separate
6 return basis.

7 Q. ARE THERE ANY OTHER PRO FORMA ADJUSTMENTS ASSOCIATED WITH THE
8 SEPARATE RETURN NOLC?

9 A. Yes. An adjustment of (\$1,073,834) was made to reflect the pro forma balance of
10 unamortized protected excess ADFIT. This adjustment increases the overall ADIT balance
11 which results in a reduction to rate base. The adjustment recognizes that as a result of the
12 separate return NOLC ADIT, the Average Rate Assumption Method (ARAM) would
13 produce a life-to-date amortization of protected excess ADFIT that is less than the Company
14 has amortized on its books.

16 VIII. CONCLUSION

17 Q. PLEASE SUMMARIZE YOUR CONCLUSIONS.

18 A. The income tax schedules and workpapers that are part of this filing were completed
19 consistent with the accounting methods established as precedent in previous filings. The
20 ADIT and income tax expense are fair and accurate based on the underlying rate base and
21 recoverable expenses included in the cost of service and presented on a separate return basis.
22 Tax expense and ADIT comply with IRS normalization requirements, including those
23 related to accelerated tax depreciation, NOLCs, and ITC. Adjustments made to tax expense,

1 cost of service, and to rate base are both appropriate and fair. Accordingly, the Company's
2 request to include the amount of income tax expense that is included in the cost of service
3 should be granted.

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2014

PLR/TAM 201436057 - 201436001

[PLR 201436037 -- IRC Sec\(s\). 167; 168, 09/05/14](#)

Private Letter Rulings

Private Letter Ruling 201436037, 09/05/14, IRC Sec(s). 167

UIL No. 167.22-01

Accelerated depreciation-accumulated deferred income tax-net operating loss carryover-computation based on with or without basis-normalization-limitations on reasonable allowance in case of property of public utilities.

Headnote:

Reduction of regulated electric utility's rate base by full amount of its ADIT account balances offset by portion of its NOLC-related account that is less than amount attributable to accelerated depreciation computed on "with or without" basis would be inconsistent with Code Sec. 168(i)(9); and Reg § 1.167(l)-1 requirements.

Reference(s): Code Sec. 167; Code Sec. 168;

Full Text:

Number: **201436037**

Release Date: 9/5/2014

Index Number: 167.22-01

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact: [Redacted Text]

[Redacted Text], ID No.

Telephone Number: [Redacted Text]

Refer Reply To:

CC:PSI:B06

PLR-148310-13

Date:

May 22, 2014

LEGEND:

Taxpayer =

Parent =

State A =

State B =

State C =

Commission A =

Commission B =

Commission C =

Year A =

Year B =

Date A =

Date B =

Date C =

Case =

Director =

Dear [Redacted Text]:

This letter responds to the request, dated November 25, 2013, of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is a regulated public utility incorporated in State A and State B. It is wholly owned by Parent. Taxpayer is engaged in the transmission, distribution, and supply of electricity in State A and State C. Taxpayer is subject to the regulatory jurisdiction of Commission A, Commission B, and Commission C with respect to terms and conditions of service and particularly the rates it may charge for the provision of service. Taxpayer's rates are established on a rate of return basis. Taxpayer takes accelerated depreciation, including "bonus depreciation" where available and, for each year beginning in Year A and ending in Year B, Taxpayer individually (as well as the consolidated return filed by Parent) has or expects to, produce a net operating loss (NOL). On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries - a "deferred tax asset" and a "deferred tax expense" - that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of an net operating loss carryover (NOLC). Taxpayer, for normalization purposes, calculates the portion of the NOLC attributable to accelerated depreciation using a "with or without" methodology, meaning that an NOLC is attributable to accelerated depreciation to the extent of the lesser of the accelerated depreciation or the NOLC.







Taxpayer filed a general rate case with Commission B on Date A (Case). The test year used in the Case was the 12 month period ending on Date B. In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized in accordance with Commission B policy and were not flowed thru to ratepayers. The data originally filed in Case included six months of forecast data, which the Taxpayer updated with actual data in the course of proceedings. In establishing the rate base on which Taxpayer was to be allowed to earn a return Commission B offset rate base by Taxpayer's ADIT balance, using a 13-month average of the month-end balances of

the relevant accounts. Taxpayer argued that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Testimony by various other participants in Case argued against Taxpayer's proposed calculation of ADIT. One proposal made to Commission B was, if Commission B allowed Taxpayer to reduce the ADIT balance as Taxpayer proposed, then Taxpayer's income tax expense element of service should be reduced by that same amount.




Commission B, in an order issued on Date C, allowed Taxpayer to reduce ADIT by the amount that Taxpayer calculates did not actually defer tax due to the presence of the NOLC and ordered Taxpayer to seek a ruling on the effects of an NOLC on ADIT. Rates went into effect on Date C.


Taxpayer proposed, and Commission B accepted, that it be permitted to annualize, rather than average, its reliability plant additions and to extend the period of anticipated reliability plant additions to be included in rate base for an additional quarter. Taxpayer also proposed, and Commission B accepted, that no additional ADIT be reflected as a result of these adjustments inasmuch as any additional book and tax depreciation produced by considering these assets would simply increase Taxpayer's NOLC and thus there would be no net impact on ADIT.





Taxpayer requests that we rule as follows:





1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balances offset by a portion of its NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with or without" basis would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.
2. The imputation of incremental ADIT on account of the reliability plant addition adjustments described above would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1.
3. Under the circumstances described above, any reduction in Taxpayer's tax expense element of cost of service to reflect the tax benefit of its NOLC would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1.






Law and Analysis


 Section 168(f)(2) of the Code provides that the depreciation deduction determined under  section 168 shall not apply to any public utility property (within the meaning of  section 168(i)(10)) if the taxpayer does not use a normalization method of accounting.


In order to use a normalization method of accounting,  section 168(i)(9)(A)(i) of the Code requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes



and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under  section 168(i)(9)(A)(ii), if the amount allowable as a deduction under  section 168 differs from the amount that would be allowable as a deduction under  section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under  section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.





 Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of  section 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under  section 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under  section 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.



Former  section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former  section 167(l)(3)(G) in a manner consistent with that found in  section 168(i)(9)(A).  Section 1.167(1)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under  section 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.



 Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.




 Section 1.167(1)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This

amount shall be taken into account for the taxable year in which the different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a subsection (1) method for purposes of determining the taxpayer's reasonable allowance under  section 167(a) results in a net operating loss carryover to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under  section 167(a) using a subsection (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.


 Section 1.167(1)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under  section 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under  section 1.167(1)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under  section 167(a).


 Section 1.167(1)-(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under  section 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.


 Section 1.167(1)-(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under  section 1.167(1)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

 Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so.  Section 1.167(1)-(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. 

Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.

In Case, Commission B has reduced rate base by Taxpayer's ADIT account, as modified by the account which Taxpayer has designed to calculate the effects of the NOLC. 







Section 1.167(1)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes. Further, while that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements.  Section 1.167(1)-(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the order by Commission B is in accord with the normalization requirements. The "with or without" methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers. Under these facts, any method other than the "with and without" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

Regarding the second issue,  § 1.167(1)-(h)(6)(i) provides, as noted above, that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Increasing Taxpayer's ADIT

account by an amount representing those taxes that would have been deferred absent the NOLC increases the ADIT reserve account (which will then reduce rate base) beyond the permissible amount.


Regarding the third issue, reduction of Taxpayer's tax expense element of cost of service, we believe that such reduction would, in effect, flow through the tax benefits of accelerated depreciation deductions through to rate payers even though the Taxpayer has not yet realized such benefits. This would violate the normalization provisions.

We rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balances offset by a portion of its NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with or without" basis would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.
2. The imputation of incremental ADIT on account of the reliability plant addition adjustments described above would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1.
3. Under the circumstances described above, any reduction in Taxpayer's tax expense element of cost of service to reflect the tax benefit of its NOLC would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it.  Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman

Senior Technician Reviewer, Branch 6

(Passthroughs & Special Industries)

cc: [Redacted Text]

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2014

PLR/TAM 201438036 - 201438001

[PLR 201438003 -- IRC Sec\(s\). 167; 168, 09/19/2014](#)

Private Letter Rulings

Private Letter Ruling 201438003, 09/19/2014, IRC Sec(s). 168

UIL No. 167.22-01

Accelerated depreciation-accumulated deferred income tax-net operating loss carryover-normalization-limitations on reasonable allowance in case of property of public utilities.

Headnote:

Reduction of taxpayer/regulated electric utility's rate base by full amount of its ADIT account balance unreduced by balance of NOLC-related account balance would be inconsistent with Code Sec. 168(i)(9); and Reg § 1.167(l)-1 requirements.

Reference(s): Code Sec. 168; Code Sec. 167;

Full Text:

Number: **201438003**

Release Date: 9/19/2014

Index Number: 167.22-01

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact: [Redacted Text]

[Redacted Text], ID No.

Telephone Number: [Redacted Text]

Refer Reply To:

CC:PSI:B06

PLR-104157-14

Date:

June 12, 2014

LEGEND:

Taxpayer =

Parent =

State A =

Commission A =

Commission B =

Year A =

Year B =

Year C =

Year D =

Date A =

Date B =

Date C =

Date D =

Case =

Director =

Dear [Redacted Text]:

This letter responds to the request, dated January 24, 2014, and additional submission dated May 19, 2014, submitted on behalf of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is a regulated, investor-owned public utility incorporated under the laws of State A primarily engaged in the business of supplying electricity in State A. Taxpayer is subject to the regulatory jurisdiction of Commission A and Commission B with respect to terms and conditions of service and particularly the rates it may charge for the provision of service. Taxpayer's rates are established on a rate of return basis.

Taxpayer is wholly owned by Parent, and Taxpayer is included in a consolidated federal income tax return of which Parent is the common parent. Taxpayer employs the accrual method of accounting and reports on a calendar year basis.

Taxpayer filed a rate case application on Date A (Case). In its filing, Taxpayer used as its starting point actual data from the historic test period, calendar Year A. It then projected data for Year B through Year C. Taxpayer updated, amended, and supplemented its data several times during the course of the proceedings. Rates in this proceeding were intended to, and did, go into effect for the period Date B through Date C.

In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized and were not flowed thru to ratepayers.

In its rate case filing, Taxpayer anticipated that it would claim accelerated depreciation, including "bonus depreciation" on its tax returns to the extent that such depreciation was available in all years for which data was provided. Additionally, Taxpayer forecasted that it would incur a net operating loss (NOL) in Year D. Taxpayer anticipated that it had the capacity to carry back a portion of this NOL with the remainder producing a net operating loss carryover (NOLC) as of the end of Year D.







On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting

series of entries - a "deferred tax asset" and a "deferred tax expense" - that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of an NOLC.




In the setting of utility rates in State, a utility's rate base is offset by its ADIT balance. In its rate case filing and throughout the proceeding, Taxpayer maintained that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Thus, Taxpayer argued that the rate base should be reduced as of the end of Year D by its federal ADIT balance net of the deferred tax asset account attributable to the federal NOLC. It based this position on its determination that this net amount represented the true measure of federal income taxes deferred on account of its claiming accelerated tax depreciation deductions and, consequently, the actual quantity of "cost-free" capital available to it. It also asserted that the failure to reduce its rate base offset by the deferred tax asset attributable to the federal NOLC would be inconsistent with the normalization rules. Testimony by another participant in Case argued against Taxpayer's proposed calculation of ADIT.






Commission A, in an order issued on Date D, held that it is inappropriate to include the NOL in rate base for ratemaking purposes. Commission A further stated that it is the intent of the Commission that Taxpayer comply with the normalization method of accounting and tax normalization regulations. Commission noted that if Taxpayer later obtains a ruling from the IRS which affirms Taxpayer's position, Taxpayer may file seeking an adjustment. Commission A also held that to the extent tax normalization rules require recording the NOL to rate base in the specified years, no rate of return is authorized.





Taxpayer requests that we rule as follows:






1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.
2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with and without" basis would be inconsistent with (and, hence, violative of) the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.
3. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of  § 168(i)(9) and  § 1.167(l)-1.

Law and Analysis

 Section 168(f)(2) of the Code provides that the depreciation deduction determined under  section 168 shall not apply to any public utility property (within the meaning of  section 168(i)(10)) if the taxpayer does not use a normalization method of accounting.






In order to use a normalization method of accounting,  section 168(i)(9)(A)(i) of the Code requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under  section 168(i)(9)(A)(ii), if the amount allowable as a deduction under  section 168 differs from the amount that would be allowable as a deduction under  section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under  section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.





 Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of  section 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under  section 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under  section 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.



Former  section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former  section 167(l)(3)(G) in a manner consistent with that found in  section 168(i)(9)(A).  Section 1.167(l)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under  section 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.


 Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should


reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.




 Section 1.167(l)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a  subsection (1) method for purposes of determining the taxpayer's reasonable allowance under  section 167(a) results in a net operating loss carryover to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under  section 167(a) using a  subsection (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

 Section 1.167(l)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under  section 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under  section 1.167(l)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under  section 167(a).


 Section 1.167(l)-1(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under  section 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.



 Section 1.167(l)-1(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax

expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under  section 1.167(l)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

 Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so.  Section 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. 

Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.







Regarding the first issue,  § 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the order by Commission A is not in accord with the normalization requirements.

Regarding the second issue,  § 1.167(l)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes.  Section 1.167(l)-1(h)(1)(iii) provides generally that, if, in respect of any year, the use of other than regulatory depreciation for tax purposes results in an NOLC carryover (or an increase in an NOLC which would not have arisen had the taxpayer claimed only regulatory depreciation for tax purposes), then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director. While that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements. The "with or without" methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the

amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers. Under these facts, any method other than the "with and without" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.


Regarding the third issue, assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would, in effect, flow the tax benefits of accelerated depreciation deductions through to rate payers. This would violate the normalization provisions.

We rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.
2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with and without" basis would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.
3. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it.  Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman

Senior Technician Reviewer, Branch 6

(Passthroughs & Special Industries)

cc: [Redacted Text]

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2015

PLR/TAM 201519028 - 201519001

[PLR 201519021 -- IRC Sec\(s\). 167; 168, 05/08/2015](#)

Private Letter Rulings

Private Letter Ruling 201519021, 05/08/2015, IRC Sec(s). 168

UIL No. 167.22-01

Accelerated depreciation-accumulated deferred income tax-net operating loss carryover-normalization-limitations on reasonable allowance in case of property of public utilities.

Headnote:

Reduction of taxpayer/investor-owned public utility's rate base by full amount of its ADIT account balance unreduced by balance of NOLC-related account balance would be inconsistent with Code Sec. 168(i)(9); and Reg § 1.167(l)-1 requirements.

Reference(s): Code Sec. 168; Code Sec. 167;

Full Text:

Number: **201519021**

Release Date: 5/8/2015

Index Number: 167.22-01

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact: [Redacted Text]

[Redacted Text], ID No.

Telephone Number: [Redacted Text]

Refer Reply To:

CC:PSI:B06

PLR-136851-14

Date:

February 04, 2015

LEGEND:

Taxpayer =

Parent =

State A =

Commission =

Year A =

Year B =

Year C =

Year D =

Date A =

Date B =

Date C =

Date D =

Case =

Director =

Dear [Redacted Text]:

This letter responds to the request, dated October 1, 2014, submitted on behalf of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is a regulated, investor-owned public utility incorporated under the laws of State A primarily engaged in the business of supplying natural gas service in State A. Taxpayer is subject to the regulatory jurisdiction of Commission with respect to terms and conditions of service and as to the rates it may charge for the provision of service. Taxpayer's rates are established on a cost of service basis.

Taxpayer is wholly owned by Parent, and Taxpayer is included in a consolidated federal income tax return of which Parent is the common parent. Taxpayer employs the accrual method of accounting and reports on a calendar year basis.

Taxpayer filed a rate case application on Date A (Case). In its filing, Taxpayer used as its starting point actual data from the historic test period, calendar Year A. It then projected data for Year B through Year D. Taxpayer updated, amended, and supplemented its data several times during the course of the proceedings. Rates in this proceeding were intended to, and did, go into effect for the period Date B through Date C.

In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized and were not flowed thru to ratepayers.

In its rate case filing, Taxpayer anticipated that it would claim accelerated depreciation, including "bonus depreciation" on its tax returns to the extent that such depreciation was available in all years for which data was provided. Additionally, Taxpayer forecasted that it would incur a net operating loss (NOL) in each of Year B, Year C, and Year D. Taxpayer anticipated that it had the capacity to carry back a portion of this NOL with the remainder producing a net operating loss carryover (NOLC) as of the end of Year C and Year D, the beginning and end of the test period.







On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries - a "deferred tax asset" and a "deferred tax expense" - that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the

existence of an NOLC.




In the setting of utility rates in State, a utility's rate base is offset by its ADIT balance. In its rate case filing and throughout the proceeding, Taxpayer maintained that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Thus, Taxpayer argued that the rate base should be reduced as of the end of Year D by its federal ADIT balance net of the deferred tax asset account attributable to the federal NOLC. It based this position on its determination that this net amount represented the true measure of federal income taxes deferred on account of its claiming accelerated tax depreciation deductions and, consequently, the actual quantity of "cost-free" capital available to it. It also asserted that the failure to reduce its rate base offset by the deferred tax asset attributable to the federal NOLC would be inconsistent with the normalization rules. Testimony by another participant in Case argued against Taxpayer's proposed calculation of ADIT.

Commission, in an order issued on Date D, held that it is inappropriate to include the NOL in rate base for ratemaking purposes. Commission further stated that it is the intent of the Commission that Taxpayer comply with the normalization method of accounting and tax normalization regulations. Commission noted that if Taxpayer later obtains a ruling from the IRS which affirms Taxpayer's position, Taxpayer may file seeking an adjustment. Commission also held that to the extent tax normalization rules require including the NOL in rate base in the specified years, no rate of return is authorized.






Taxpayer requests that we rule as follows:





1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.
2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with and without" basis would be inconsistent with (and, hence, violative of) the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.
3. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of  § 168(i)(9) and  § 1.167(l)-1.






Law and Analysis


 Section 168(f)(2) of the Code provides that the depreciation deduction determined under  section 168 shall not apply to any public utility property (within the meaning of  section 168(i)(10)) if






the taxpayer does not use a normalization method of accounting.





In order to use a normalization method of accounting,  section 168(i)(9)(A)(i) of the Code requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under  section 168(i)(9)(A)(ii), if the amount allowable as a deduction under  section 168 differs from the amount that would be allowable as a deduction under  section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under  section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.



 Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of  section 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under  section 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under  section 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.



Former  section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former  section 167(l)(3)(G) in a manner consistent with that found in  section 168(i)(9)(A).  Section 1.167(l)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under  section 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

 Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.




 Section 1.167(l)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a  subsection (1) method for purposes of determining the taxpayer's reasonable allowance under  section 167(a) results in a net operating loss carryover to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under  section 167(a) using a  subsection (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

 Section 1.167(l)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under  section 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under  section 1.167(l)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under  section 167(a).


 Section 1.167(l)-1(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under  section 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.



 Section 1.167(l)-1(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under  section 1.167(l)-1(h)(2)(i)) at the end of the historical period. If

such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

 Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so.  Section 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. 

Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.







Regarding the first issue,  § 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the order by Commission is not in accord with the normalization requirements.

Regarding the second issue,  § 1.167(l)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes.  Section 1.167(l)-1(h)(1)(iii) provides generally that, if, in respect of any year, the use of other than regulatory depreciation for tax purposes results in an NOLC carryover (or an increase in an NOLC which would not have arisen had the taxpayer claimed only regulatory depreciation for tax purposes), then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director. While that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements. The "with or without" methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers.

Under these specific facts, any method other than the "with and without" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.


Regarding the third issue, assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would, in effect, flow the tax benefits of accelerated depreciation deductions through to rate payers. This would violate the normalization provisions.

We rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.
2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with and without" basis would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.
3. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it.  Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman

Senior Technician Reviewer, Branch 6

Office of the Associate Chief Counsel

(Passthroughs & Special Industries)

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2015

PLR/TAM 201534020 - 201534001

[PLR 201534001 -- IRC Sec\(s\). 167; 168, 08/21/2015](#)

Private Letter Rulings

Private Letter Ruling 201534001, 08/21/2015, IRC Sec(s). 168

UIL No. 167.22-01

**Accelerated depreciation-accumulated deferred income
tax-net operating loss
carryforward-normalization-limitations on reasonable
allowance in case of property of public utilities.**

Headnote:

Reduction of taxpayer/common parent/regulated natural gas distributor's rate base by full amount of its ADIT account balance unreduced by balance of NOLC-related account balance would be inconsistent with Code Sec. 168(i)(9); and Reg § 1.167(l)-1 requirements.

Reference(s): Code Sec. 168; Code Sec. 167;

Full Text:

Number: **201534001**

Release Date: 8/21/2015

Index Number: 167.22-01

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact: [Redacted Text]

[Redacted Text], ID No.

Telephone Number: [Redacted Text]

Refer Reply To:

CC:PSI:B06

PLR-103300-15

Date:

May 13, 2015

LEGEND:

Taxpayer =

State A =

State B =

State C =

Commission =

Year A =

Year B =

Date A =

Date B =

Date C =

Date D =

Case =

Director =

Dear [Redacted Text]:

This letter responds to the request, dated January 9, 2015, submitted on behalf of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is the common parent of an affiliated group of corporations and is incorporated under the laws of State A and State B. Taxpayer is engaged primarily in the businesses of regulated natural gas distribution, regulated natural gas transmission, and regulated natural gas storage. Taxpayer's regulated natural gas distribution business delivers gas to customers in several states, including State A. Taxpayer is subject to, as relevant for this ruling, the regulatory jurisdiction of Commission with respect to terms and conditions of service and as to the rates it may charge for the provision of its gas distribution service in State A. Taxpayer's rates are established on a "rate of return" basis.





Taxpayer filed a rate case application on Date A (Case). In its filing, Taxpayer's application was based on a fully forecasted test period consisting of the twelve months ending on Date B. Taxpayer updated, amended, and supplemented its data several times during the course of the proceedings. In a final order dated Date C, rates were approved by Commission for service rendered on or after Date D.

In each year from Year A to Year B, Taxpayer incurred a net operating loss carryforward (NOLC). In each of these years, Taxpayer claimed accelerated depreciation, including "bonus depreciation" on its tax returns to the extent that such depreciation was available. On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries - a "deferred tax asset" and a "deferred tax expense" - that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of an NOLC.




In the setting of utility rates in State C, a utility's rate base is offset by its ADIT balance. In its rate case filing and throughout the proceeding, Taxpayer maintained that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Thus, Taxpayer argued that the rate base should be reduced by its federal ADIT balance net of the deferred tax asset account attributable to the federal NOLC. It also asserted that the failure to reduce its rate base offset by the deferred tax asset attributable to the federal NOLC would be inconsistent with the normalization rules. The attorney general for State C argued against Taxpayer's proposed calculation of ADIT.






Commission, in its final order, agreed with Taxpayer but concluded that the ambiguity in the relevant normalization regulations warranted an assessment of the issue by the IRS and this ruling request followed.





Taxpayer requests that we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.
2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account that is less than the amount attributable to accelerated depreciation computed on a "last dollars deducted" basis would be inconsistent with (and, hence, violative of) the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.






Law and Analysis


 Section 168(f)(2) of the Code provides that the depreciation deduction determined under  section 168 shall not apply to any public utility property (within the meaning of  section 168(i)(10)) if the taxpayer does not use a normalization method of accounting.






In order to use a normalization method of accounting,  section 168(i)(9)(A)(i) of the Code requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under  section 168(i)(9)(A)(ii), if the amount allowable as a deduction under  section 168 differs from the amount that would be allowable as a deduction under  section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under  section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.



 Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of  section 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under  section 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under  section 168(i)(9)(A)(ii),



unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.



Former  section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former  section 167(l)(3)(G) in a manner consistent with that found in  section 168(i)(9)(A).  Section 1.167(l)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under  section 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.



 Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.




 Section 1.167(l)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a  subsection (1) method for purposes of determining the taxpayer's reasonable allowance under  section 167(a) results in a net operating loss carryover to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under  section 167(a) using a  subsection (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

 Section 1.167(l)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under  section 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount


for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under  section 1.167(l)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under  section 167(a).



 Section 1.167(l)-1(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under  section 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.



 Section 1.167(l)-1(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under  section 1.167(l)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

 Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so.  Section 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. 

Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.


Regarding the first issue,  § 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of

capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, to reduce Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1.

Regarding the second issue,  § 1.167(l)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes.  Section 1.167(l)-1(h)(1)(iii) provides generally that, if, in respect of any year, the use of other than regulatory depreciation for tax purposes results in an NOLC carryover (or an increase in an NOLC which would not have arisen had the taxpayer claimed only regulatory depreciation for tax purposes), then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director. While that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements. The "last dollars deducted" methodology employed by Taxpayer ensures that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers. Under these specific facts, any method other than the "last dollars deducted" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it.  Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman

Senior Technician Reviewer, Branch 6

Office of the Associate Chief Counsel

(Passthroughs & Special Industries)

cc: [Redacted Text]

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2015

PLR/TAM 201548027 - 201548001

[PLR 201548017 -- IRC Sec\(s\). 167; 168, 11/27/2015](#)

Private Letter Rulings

Private Letter Ruling 201548017, 11/27/2015, IRC Sec(s). 168

UIL No. 167.22-01

**Accelerated depreciation-accumulated deferred income
tax-net operating loss
carryforward-normalization-limitations on reasonable
allowance in case of property of public utilities.**

Headnote:

Reduction of taxpayer/regulator natural gas distributor's rate base by balance of its ADIT accounts unreduced by its NOLC-related deferred tax account, by full amount of its ADIT account balances offset by portion of NOLC-related account balances, or any reduction in taxpayer's tax expense element of cost of service to reflect tax benefit of its NOLC would be inconsistent with Code Sec. 168(i)(9); and Reg § 1.167(l)-1 requirements.

Reference(s): Code Sec. 168; Code Sec. 167;

Full Text:

Number: **201548017**

Release Date: 11/27/2015

Index Number: 167.22-01

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact: [Redacted Text]

[Redacted Text], ID No.

Telephone Number: [Redacted Text]

Refer Reply To:

CC:PSI:B06

PLR-116998-15

Date:

August 19, 2015

LEGEND:

Taxpayer =

Parent =

State A =

State B =

Commission =

Year A =

Year B =

Date A =

Date B =

Case =

Director =

Dear [Redacted Text]:

This letter responds to the request, dated May 14, 2015, of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.







The representations set out in your letter follow.

Taxpayer is primarily engaged in the regulated distribution of natural gas in State A. It is incorporated in State B and is wholly owned by Parent. Taxpayer is subject to the regulatory jurisdiction of Commission with respect to terms and conditions of service and particularly the rates it may charge for the provision of service. Taxpayer's rates are established on a rate of return basis. Taxpayer takes accelerated depreciation, including "bonus depreciation" where available and, for each year beginning in Year A and ending in Year B, Taxpayer incurred net operating losses (NOL). On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries - a "deferred tax asset" and a "deferred tax expense" - that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of an net operating loss carryover (NOLC). Taxpayer, for normalization purposes, calculates the portion of the NOLC attributable to accelerated depreciation using a "last dollars deducted" methodology, meaning that an NOLC is attributable to accelerated depreciation to the extent of the lesser of the accelerated depreciation or the NOLC.




Taxpayer filed a general rate case with Commission on Date A (Case). The test year used in the Case was the 12 month period ending on Date B. In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized in accordance with Commission policy and were not flowed thru to ratepayers. In establishing the rate base on which Taxpayer was to be allowed to earn a return Commission offsets rate base by Taxpayer's ADIT balance. Taxpayer argued that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Testimony by various other participants in Case argued against Taxpayer's proposed calculation of ADIT. One proposal made to Commission was, if Commission allowed Taxpayer to reduce the ADIT balance as Taxpayer proposed, then an offsetting reduction should be made to Taxpayer's income tax expense element of service.






A Utility Law Judge upheld Taxpayer's position with respect to the NOLC-related ADIT and ordered Taxpayer to seek a ruling from the Internal Revenue Service on this matter. This request is in response to that order.





Taxpayer requests that we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the balance of its ADIT accounts unreduced by its NOLC-related deferred tax account would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.
2. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balances offset by a portion of its NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "last dollars deducted" basis would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1.
3. Under the circumstances described above, any reduction in Taxpayer's tax expense element of cost of service to reflect the tax benefit of its NOLC would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1.






Law and Analysis


 Section 168(f)(2) of the Code provides that the depreciation deduction determined under  section 168 shall not apply to any public utility property (within the meaning of  section 168(i)(10)) if the taxpayer does not use a normalization method of accounting.






In order to use a normalization method of accounting,  section 168(i)(9)(A)(i) of the Code requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under  section 168(i)(9)(A)(ii), if the amount allowable as a deduction under  section 168 differs from the amount that would be allowable as a deduction under  section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under  section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.



 Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of  section 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under  section 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under  section 168(i)(9)(A)(ii),



unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.



Former  section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former  section 167(l)(3)(G) in a manner consistent with that found in  section 168(i)(9)(A).  Section 1.167(1)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under  section 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.



 Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.




 Section 1.167(1)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a  subsection (1) method for purposes of determining the taxpayer's reasonable allowance under  section 167(a) results in a net operating loss carryover to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under  section 167(a) using a  subsection (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

 Section 1.167(1)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under  section 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount



for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under  section 1.167(1)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under  section 167(a).

 Section 1.167(1)-(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under  section 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.


 Section 1.167(1)-(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under  section 1.167(1)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

 Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so.  Section 1.167(1)-(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. 

Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.



 Section 1.167(1)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes. Further, while that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements.  Section 1.167(1)-(h)(6)(i) provides that a taxpayer does not use a


normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the proposed order by the Utility Law Judge upholding Taxpayer's position that the NOLC-related deferred tax account must be included in the calculation of Taxpayer's ADIT is in accord with the normalization requirements. The "last dollars deducted" methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers. Under these facts, any method other than the "last dollars deducted" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

Regarding the third issue, reduction of Taxpayer's tax expense element of cost of service, we believe that such reduction would, in effect, flow through the tax benefits of accelerated depreciation deductions through to rate payers even though the Taxpayer has not yet realized such benefits. In addition, such adjustment would be made specifically to mitigate the effect of the normalization rules in the calculation of Taxpayer's NOLC-related ADIT. In general, taxpayers may not adopt any accounting treatment that directly or indirectly circumvents the normalization rules. See generally,  §



1.46-6(b)(2)(ii) (In determining whether, or to what extent, the investment tax credit has been used to reduce cost of service, reference shall be made to any accounting treatment that affects cost of service); Rev. Proc 88-12, 1988-1 C.B. 637, 638 (It is a violation of the normalization rules for taxpayers to adopt any accounting treatment that, directly or indirectly flows excess tax reserves to ratepayers prior to the time that the amounts in the vintage accounts reverse). This "offsetting reduction" would violate the normalization provisions.

Based on the representations submitted by Taxpayer, we rule as follows:


1. Under the circumstances described above, the reduction of Taxpayer's rate base by the balance of its ADIT accounts unreduced by its NOLC-related deferred tax account would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1 of the Income Tax regulations.

2. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balances offset by a portion of its NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "last dollars deducted" basis would be inconsistent with the requirements of  § 168(i)(9) and

 § 1.167(l)-1.

3. Under the circumstances described above, any reduction in Taxpayer's tax expense element of cost of service to reflect the tax benefit of its NOLC would be inconsistent with the requirements of  § 168(i)(9) and  § 1.167(l)-1.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it.  Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman

Senior Technician Reviewer, Branch 6

Office of Associate Chief Counsel

(Passthroughs & Special Industries)

cc: [Redacted Text]

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2017

PLR/TAM 201709023 - 201709001

[PLR 201709008 -- IRC Sec\(s\). 167; 168, 03/03/17](#)

Private Letter Rulings

Private Letter Ruling 201709008, 03/03/17, IRC Sec(s). 168

UIL No. 167.22-01

**Accelerated cost recovery
system-normalization-accumulated deferred income tax-net
operating loss carryforward-limitations on reasonable
allowance in case of property of public utilities.**

Headnote:

In order to avoid violation of Code Sec. 168(i)(9); 's and Reg § 1.167(l)-1 's normalization requirements, it was necessary to include in regulated integrated electric utility/sub.'s rate base ADIT asset resulting from NOL carryforward, given inclusion in rate base of full amount of ADIT liability resulting from accelerated tax depreciation.

Reference(s): Code Sec. 168; Code Sec. 167;

Full Text:

Number: **201709008**

Release Date: 3/3/2017

Index Number: 167.22-01

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact: [Redacted Text]

[Redacted Text], ID No.

Telephone Number: [Redacted Text]

Refer Reply To:

CC:PSI:B06

PLR-119381-16

Date:

December 02, 2016

LEGEND:

Taxpayer =

Parent =

State =

Commission A =

Commission B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Case =

Year 1 =

Year 2 =

Director =

Dear [Redacted Text]:

This letter responds to the request, dated June 15, 2016, submitted by Parent on behalf of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is an integrated electric utility headquartered in State. Taxpayer is a wholly owned subsidiary of Parent and is included in Parent's consolidated federal income tax return. Taxpayer employs the accrual method of accounting and reports on a calendar year basis.

Taxpayer's business includes retail electric utility operations regulated within State by Commission A and Taxpayer is subject to the regulatory jurisdiction of Commission B with respect to terms and conditions of its wholesale electric transmission service and as to the rates it may charge for the provision of such services. Taxpayer's rates are established on a cost of service basis.

On Date 1, Taxpayer filed a rate case application (Case) with Commission B requesting authorization to change from charging stated rates for wholesale electric transmission service to a formula rate mechanism pursuant to which rates for wholesale transmission service are calculated annually in accordance with an approved formula. The proposed formula consisted of updating cost of service components, including investment in plant and operating expenses, based on information contained in Taxpayer's annual financial report filed with Commission B, as well as including projected transmission capital projects to be placed into service in the following year. The projections included are subject to true-up in the following year's formula rate.

In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized and were not flowed thru to ratepayers.

In its rate case filing, Taxpayer anticipated that it would claim accelerated depreciation, including "bonus depreciation" on its tax returns to the extent that such depreciation was available. Taxpayer incurred a net operating loss (NOL) in each of Year 1 through Year 2 due to Taxpayer's claiming bonus depreciation, producing a net operating loss carryover (NOLC).

On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income





tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries - a "deferred tax asset" and a "deferred tax expense" - that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of a NOLC.

In the setting of utility rates by Commission B, a utility's rate base is offset by its ADIT balance. In its rate case filing, Taxpayer maintained that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Thus, Taxpayer argued that the rate base should be reduced by its federal ADIT balance net of the deferred tax asset account attributable to the federal NOLC. It based this position on its determination that this net amount represented the true measure of federal income taxes deferred on account of its claiming accelerated tax depreciation deductions and, consequently, the actual quantity of "cost-free" capital available to it. It also asserted that the failure to reduce its rate base offset by the deferred tax asset attributable to the federal NOLC would be inconsistent with the normalization rules.




On Date 2, Commission B issued an order accepting Taxpayer's revisions to its rates. On Date 3, new rates went into effect, subject to refund. Several intervenors submitted challenges to the rate case and on Date 4, Taxpayer and those intervenors entered into a Settlement Agreement, which was filed with Commission B. On Date 5, Commission B issued an order accepting the Settlement Agreement, which allows for the inclusion of the ADIT related to the NOLC asset in rate base.






Commission B further stated in the order that it is the intent of Commission B that Taxpayer comply with the normalization method of accounting and tax normalization regulations. The order also requires Taxpayer to seek a private letter ruling (PLR) from the Service regarding Taxpayer's treatment of the ADIT related to the NOLC asset. Commission B also noted that after the Service issues a PLR, Taxpayer shall adjust, to the extent necessary, its ratemaking treatment of the ADIT related to the NOLC asset prospectively from the date of the PLR.





Taxpayer requests that we rule as follows:




1. In order to avoid a violation of the normalization requirements of  § 168(i)(9) and  Treasury Regulation § 1.167(l)-1, it is necessary to include in rate base the Accumulated Deferred Income Tax (ADIT) asset resulting from the Net Operating Loss Carryforward (NOLC), given the inclusion in rate base of the full amount of the ADIT liability resulting from accelerated tax depreciation.
2. The exclusion from rate base of the entire ADIT asset resulting from the NOLC, or the inclusion in rate base of a portion of that ADIT asset that is less than the amount attributable to accelerated tax depreciation, computed on a "with and without" basis, would violate the normalization requirements of  § 168(i)(9) and  § 1.167(l)-1.



Law and Analysis


 Section 168(f)(2) of the Code provides that the depreciation deduction determined under  § 168 shall not apply to any public utility property (within the meaning of  § 168(i)(10)) if the taxpayer does not use a normalization method of accounting.

In order to use a normalization method of accounting,  § 168(i)(9)(A)(i) requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under  § 168(i)(9)(A)(ii), if the amount allowable as a deduction under  § 168 differs from the amount that would be allowable as a deduction under  § 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under  § 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.






 Section 168(i)(9)(B)(i) provides that one way the requirements of  § 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under  § 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under  § 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.





Former  § 167(l) generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former  § 167(l)(3)(G) in a manner consistent with that found in  § 168(i)(9)(A).



 Section 1.167(l)-1(a)(1) provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under  § 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.


 Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should


reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.




 Section 1.167(l)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a  subsection (1) method for purposes of determining the taxpayer's reasonable allowance under  § 167(a) results in a net operating loss carryover to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under  § 167(a) using a  subsection (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

 Section 1.167(l)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under  § 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under  § 1.167(l)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under  § 167(a).


 Section 1.167(l)-1(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under  § 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.



 Section 1.167(l)-1(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount

of the reserve (determined under  § 1.167(l)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

 Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so.  Section 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. 





Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.

Regarding the first issue,  § 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the reserve account for deferred taxes (ADIT), reduces rate base, it is clear that the portion of the net operating loss carryover (NOLC) that is attributable to accelerated depreciation must be taken into account in calculating the amount of the ADIT account balance. Thus, the order by Commission to include in rate base the ADIT asset resulting from the NOLC, given the inclusion in rate base of the full amount of the ADIT liability resulting from accelerated tax depreciation is in accord with the normalization requirements.

Regarding the second issue,  § 1.167(l)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes.  Section 1.167(l)-1(h)(1)(iii) provides generally that, if, in respect of any year, the use of other than regulatory depreciation for tax purposes results in an NOLC carryover (or an increase in an NOLC which would not have arisen had the taxpayer claimed only regulatory depreciation for tax purposes), then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director. The "with or without" methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated


depreciation to ratepayers. Under these specific facts, any method other than the "with or without" method would not provide the same level of certainty and therefore the use of any other methodology in computing the portion of the ADIT asset attributable to accelerated depreciation is inconsistent with the normalization rules.

We rule as follows:

1. In order to avoid a violation of the normalization requirements of  § 168(i)(9) and  Treasury Regulation § 1.167(l)-1, it is necessary to include in rate base the Accumulated Deferred Income Tax (ADIT) asset resulting from the Net Operating Loss Carryforward (NOLC), given the inclusion in rate base of the full amount of the ADIT liability resulting from accelerated tax depreciation.
2. The exclusion from rate base of the entire ADIT asset resulting from the NOLC, or the inclusion in rate base of a portion of that ADIT asset that is less than the amount attributable to accelerated tax depreciation, computed on a "with and without" basis, would violate the normalization requirements of  § 168(i)(9) and  § 1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it.  Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Patrick S. Kirwan

Chief, Branch 6

Office of the Associate Chief Counsel

(Passthroughs & Special Industries)

cc: [Redacted Text]

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Private Letter Rulings & Technical Advice Memoranda (1950 to Present)

2020

PLR/TAM 202010008 - 202010001

[PLR 202010002 -- IRC Sec\(s\). 168, 03/06/2020](#)

Private Letter Rulings

Private Letter Ruling 202010002, 03/06/2020, IRC Sec(s). 168

UIL No. 168.24-01

**Depreciation-accelerated cost recovery
system-accumulated deferred income taxes-rate base
calculations-normalization rules-net operating loss
carryforwards-public utilities.**

Headnote:

In order to comply with normalization method of accounting within meaning of Code Sec. 168(i)(9); under described circumstances, amount of depreciation-related ADIT reducing rate base used to determine revenue requirement set in surcharge proceeding must be decreased to reflect portion of NOL for test period for that proceeding which wouldn't have arisen had taxpayer not reported depreciation-related book/tax differences during test period, and such decrease in depreciation-related ADIT must be amount that is no less than amount computed using With-and-Without Method.

Reference(s): Code Sec. 168;

Full Text:

Number: **202010002**

Release Date: 3/6/2020

Index Number: 168.24-01

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact: [Redacted Text]

[Redacted Text], ID No.

Telephone Number: [Redacted Text]

Refer Reply To:

CC:PSI:B06

PLR-113227-19

Date: December 3, 2019

In Re: [Redacted Text]

LEGEND:

Taxpayer =

Parent =

State A =

State B =

Commission =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Date 10 =

Date 11 =

Date 12 =

Date 13 =

Date 14 =

Date 15 =

Date 16 =

Month 1 =

Month 2 =

Month 3 =

Month 4 =

Month 5 =

Month 6 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

a=

b=

c=

d=

e=

f=

g=

h=



i=

j=

k=

l=

Dear [Redacted Text]:

This letter responds to a request for a private letter ruling dated June 5, 2019, and submitted on behalf of Taxpayer for rulings under  § 168(i)(9) of the Internal Revenue Code and  § 1.167(l)-1 of the Income Tax Regulations (together, the "Normalization Rules") regarding the scope of the deferred tax normalization requirements and the appropriate methodology for the reduction of the accumulated deferred income tax ("ADIT") balance that decreases rate base computation when a net operating loss carryforward ("NOLC") exists. The relevant facts as represented in your submission are set forth below.

FACTS

Taxpayer files a consolidated federal income tax return on a calendar year basis with its affiliates, including its Parent. Taxpayer uses the accrual method of accounting.

Parent is incorporated in State A, and Taxpayer is incorporated in State B. Parent is a water and wastewater utility company. Taxpayer is the affiliate that operates in State B. Prices charged by Taxpayer are set by Commission. Commission sets rates that Taxpayer may charge for the furnishing or sale of water or sewage disposal services through a combination of periodic general rate case proceedings (resulting in what are commonly referred to as "base rates") and infrastructure surcharge proceedings (resulting in surcharges that are added to base rates.)

The most recent two base rate changes resulting from general rate case authorizations by Commission affecting water and wastewater revenue requirements were effective in Month 1 Year 1 and Month 2 Year 2. The most recent three rate changes resulting from infrastructure surcharge authorizations by Commission were effective in Month 3 Year 3, Month 4 Year 4 and Month 4 Year 2. Taxpayer questions whether the rates set pursuant to the most recent infrastructure surcharge proceeding comply with the deferred tax normalization requirements.

Infrastructure surcharges are regulatory mechanisms to permit recovery of capital investments and results in adjustments to rates charged outside of a general rate case for specified costs and investments. Under State B statute and Commission rulemaking, eligible water corporations may petition Commission and utilize a Infrastructure System Replacement Surcharge ("Surcharge") to recover the costs of eligible water utility main replacements and relocations.

For both general rate case proceedings and Surcharge proceedings, Taxpayer computes a revenue requirement subject to Commission approval based on recovery of a debt- and equity-based return on investment in rate base, including the cost of plant assets less accumulated book depreciation and ADIT, and a recovery of operating expenses, including depreciation expense, property tax expense, and income tax expense. For Surcharge proceedings, rate base is determined based on incremental plant expenditures incurred during a historical measurement period (not necessarily 12 months) ending shortly before rates become effective, less accumulated book depreciation and ADIT computed as of a date subsequent to the date at which gross plant is computed and closer to (but preceding) the date that rates become effective. For Surcharge proceedings, operating expenses include 12 months of annualized depreciation expense on the incremental investment in the Surcharge proceeding and any property taxes that will be paid within 12 months of filing the Surcharge application.

The deferred tax normalization matters in this request arose during the Surcharge proceeding initiated by Taxpayer in Month 5 Year 2 and resulting in a Commission order on Date 1 (the "Surcharge Case"). The Surcharge resulting from the Surcharge Case became effective on Date 2. Some of the normalization matters addressed in this ruling request related to deductions and ADIT resulting from the consent agreement that Parent received from the Service on Date 3, on behalf of itself and various affiliates, including Taxpayer, with respect to changes in tax method of accounting for costs to repair and maintain tangible property and dispositions of certain tangible depreciable property ("Consent Agreement").

State B statutes and Commission B rules provide eligible water corporations with the ability to recover certain infrastructure system replacement costs outside of a formal rate case filing via a Surcharge. A petition must be filed with the Commission for review and approval before an adjustment can be made to a water corporation's rates and charges to provide for the recovery of the costs associated with eligible infrastructure system replacements. A State B statute authorizes Commission to enter an order authorizing the water corporation to impose a Surcharge that is sufficient to recover appropriate pretax revenues. The State B statute defines the revenue requirement set in a Surcharge proceeding and provides that "appropriate pretax revenues" are the revenues necessary to produce net operating income equal to the water corporation's weighted cost of capital multiplied by the net original cost of eligible infrastructure system replacements, including recognition of accumulated deferred income taxes and accumulated depreciation associated with eligible infrastructure system replacements... among other items. Taxpayer represents that Commission and the State B courts have interpreted this statute in a strict manner thereby limiting the costs eligible for recovery or to earn a return in a Surcharge proceeding and causing costs not eligible for ratemaking consideration in a Surcharge

proceeding to only be eligible for recovery or return in the next base rate proceeding.

Taxpayer, per its petition filed with Commission on Date 4, sought to establish a Surcharge rate to provide for the recovery of actual costs for eligible infrastructure system replacements and relocations from Date 5 through Date 6, and estimated investment accounts for Date 7 through Date 8. During the course of the Surcharge case, Taxpayer provided Commission with actual expenditures for Month 5 and Month 6. The proposed Surcharge rate schedule reflected the pre-tax Surcharge revenues necessary to produce net operating income equal to Taxpayer's weighted cost of capital multiplied by the original cost of the requested infrastructure replacements that are eligible for the Surcharge, reduced by net ADIT and accumulated depreciation associated with eligible infrastructure system replacements through Date 9. Taxpayer also sought to recover all state, federal and local income or excise taxes applicable to such Surcharge income and to recover all other Surcharge costs including annualized depreciation expense and property taxes due within 12 months.

The specific test period and service period information pertaining to the Surcharge Case is:

- Rates became effective Date 2
- Actual gross plant was based on additions of certain property placed in service from Date 5 through Date 8
- Accumulated depreciation on such assets was estimated through Date 9
- Estimated ADIT related to depreciation book/tax differences associated with such expenditures to the extent also capitalized for tax purposes was computed through Date 9
- Estimated ADIT related to repair book/tax differences associated with such expenditures to the extent not capitalized for tax purposes was computed through Date 9
- Recoverable operating expenses were estimated for the period beginning Date 10 and ending Date 9

In a Surcharge proceeding, replacement mains and associated valves and hydrants comprise the plant assets included in rate base and result in the accumulated depreciation reducing rate base and the recoverable depreciation expense. The expenditures for replacement mains and associated valves addressed in a Surcharge proceeding are capitalizable for regulatory accounting purposes, but may result in a repair deduction for tax purposes or depreciable plant for tax purposes. The ADIT balance reducing rate base in a Surcharge proceeding is caused by depreciation-related and repair-related book/tax differences.


The key issues in the Surcharge case and, thus, in this ruling request, pertain to whether the tax effect of an NOLC must, pursuant to the normalization requirements, decrease the ADIT reduction to rate base related to the expenditures in the Surcharge case and, if so, the methodology to determine the amount of the NOLC adjustment subject to the normalization requirements. The return on rate base is based on the pre-tax rate of return authorized in the most recent rate order resulting from a general rate proceeding.

In the course of the Surcharge Case, Taxpayer and other participants in the proceeding analyzed the

expenditures for which Taxpayer sought recovery via the Surcharge and debated the proper regulatory treatment of Taxpayer's NOLC and tax loss incurred through the rate base determination date of the Surcharge case with respect to the costs incurred that are recoverable in the Surcharge case. The revenue requirement approved in Commission's order issued on Date 1 was lower than the revenue requirement sought by Taxpayer and is entirely attributable to differing ADIT calculations with respect to the NOLC and the resulting effects on rate base and allowed return. The approved revenue requirement in the Surcharge case was based on a rate base computation that reflects the gross ADIT liabilities associated with depreciation-related and repair-related book/tax differences, but did not reflect an ADIT asset for any portion of Taxpayer's NOLC as of the date that rate base was determined (Date 9), including the tax loss resulting from the infrastructure expenditures addressed in the Surcharge Case.

On a consolidated basis, Parent incurred tax losses in various years from Year 5 to Year 1 and, as of Date 11, had an NOLC of approximately \$a. On a separate company basis, Taxpayer incurred tax losses in various tax years from Year 5 -Year 1 and, as of Date 11, had a separate company NOLC of approximately \$b. For Year 2, Parent (on a consolidated basis) and Taxpayer (on a separate company basis) estimate that taxable income was earned and, thus, NOLC was utilized.


The revenue requirement related to the Surcharge Case is approximately \$c (pursuant to the rate order). Taxpayer asserts that the revenue requirement should have been computed to be \$d. The difference in the revenue requirement computations relates entirely to the exclusion of Taxpayer's NOLC from rate base. As of the date of the rate base determination, none of the Surcharge revenues had been billed to customers and, thus, as of such date, a taxable loss of approximately \$e had been incurred with respect to the plant-related expenditures with rates set by the Surcharge Case.


During the loss years resulting in Taxpayer's NOLC estimated as of the end of the test period for the Surcharge Case, separate company deductible depreciation-related book/tax differences were approximately \$f and separate company deductible repair-related book/tax differences were approximately \$g (plus the  § 481(a) adjustment with respect to the tax accounting method changes subject to the Consent agreement deducted in Year 5 of approximately \$h).





The NOLC reflected in ratemaking for the base rate case proceeding with rates effective in Month 2 Year 2 was based on the estimated NOLC as of the end of Year 4 of \$i, including an estimated Year 4 tax loss of \$j. The actual Year 4 tax loss reported on the Year 4 tax return was \$k. The excess of the actual Year 4 tax loss over the estimated Year 4 tax loss of \$l has yet to be reflected in ratemaking.







On Date 12, Taxpayer filed an Application for Rehearing and Motion to Defer Ruling, asking the Commission for the time to seek a private letter ruling form of guidance from the Service to address any uncertainties regarding the application of the deferred tax normalization requirements to the rate base treatment of the NOLC-related ADIT asset in computing the Surcharge case revenue requirement. On Date 13, the Commission denied Taxpayer's request for rehearing. Taxpayer filed a notice of appeal by Date 14, that initiated an appeal of the order in the Surcharge case to the State B Court of Appeals.

Taxpayer anticipates receiving a private letter ruling from the Service prior to the State B Court of Appeals issuing a final opinion in Taxpayer's appeal of the Commission denial of Taxpayer's Motion for Rehearing. If the Service rules that the Commission's decision in Taxpayer's Surcharge case ordered a method of regulatory accounting that is inconsistent with the deferred tax normalization requirements, Taxpayer believes that the Commission and Taxpayer would be procedurally able to correct the revenue requirement in a manner that compensates Taxpayer for any foregone revenue requirement relative to ADIT and rate base computations that comply with the normalization requirements.

Because Taxpayer is concerned that the order issued by Commission as part of the Surcharge case on Date 1, and the prices that became effective on Date 2, are inconsistent with the deferred tax normalization requirements, Taxpayer submitted a letter to the Service on Date 14 intended to provide the notification pursuant to  § 1.167(l)-1(h)(5) of the Regulations.

As noted, on Date 3, Taxpayer's parent corporation received the Consent Agreement from the Internal Revenue Service granting certain of its subsidiaries, including Taxpayer, permission to change their (1) method of accounting for costs to repair and maintain tangible property from capitalizing and depreciating these costs to deducting these costs under  § 162 of the Internal Revenue Code, and (2) unit of property for determining dispositions of depreciable network assets from using a method other than the functional interdependence test to using the functional interdependence test to determine the units of property. These changes in methods of accounting were effective for the taxable year beginning Date 15, and ended Date 16 (the "year of change").

These changes in methods of accounting resulted in an overall net negative  § 481(a) adjustment for Taxpayer as stated in the Consent Agreement. This overall net negative  § 481(a) adjustment consists of a net negative  § 481(a) adjustment for the repair and maintenance change in method of accounting and a net positive  § 481(a) adjustment for the disposition change in method of accounting.

The Service's consent to the above changes in methods of accounting is subject to several terms and conditions stated in the Consent Agreement. Condition nine of the Consent Agreement requires that if any item of property subject to the taxpayer's Form 3115 is public utility property within the meaning of  § 168(i)(10) or former  § 167(l)(3)(A): (A) a normalization method of accounting (within the meaning of  § 168(i)(9), former  § 168(e)(3)(B), or former  § 167(l)(3)(G), as applicable) must be used for the public utility property subject to the Form 3115; (B) as of the beginning of the year of change, the taxpayer must adjust its deferred tax reserve account or similar reserve account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the  § 481(a) adjustment applicable to the public utility property subject to the Form 3115; and (C) within 30 calendar days of filing the federal income tax return for the year of change, the










taxpayer must provide a copy of the Form 3115 (and any additional information submitted to the Service in connection with such Form 3115) to any regulatory body having jurisdiction over the public utility property subject to the Form 3115. See page 6 of the Consent Agreement.




Based on Taxpayer's interpretation of this condition in the Consent Agreement, Taxpayer has applied the normalization requirements to its repair-related and disposition-related deferred tax computations in rate proceedings since the year of change.


Prior to the year of change (Year 5), Taxpayer depreciated public utility property that was in service as of the end of the taxable year immediately preceding the year of change using different book and tax methods and lives. As a result, an amount of ADIT subject to the normalization requirements was recorded prior to the above changes in methods of accounting for repairs and dispositions (depreciation-related ADIT).




Differing assertions were made as part of the Surcharge Case. Ultimately the Commission in its final order determined that because there was not an NOL expected to be generated in Year 4, no portion of the NOLC deferred tax asset can be associated with the Surcharge property.


RULINGS REQUESTED


- 1) The property otherwise depreciable under  § 168(a) and for which cost recovery and return on investment initially occur as part of the Surcharge Case, rather than as part of base rates set in less frequent general rate case proceedings, constitutes public utility property within the meaning of  § 168(i)(10).
- 2) The ADIT amounts used in computing the revenue requirement set in the Surcharge Case with respect to public utility property within the meaning of  § 168(i)(10) must comply with the normalization method of accounting within the meaning of  § 168(i)(9).
- 3) For any public utility property within the meaning of  § 168(i)(10) as of the end of the tax year immediately preceding the year of change for the changes in tax method of accounting subject to Taxpayer's Consent Agreement, the depreciation-related ADIT prior to the change in tax method of accounting for repairs and dispositions remains subject to the normalization method of accounting within the meaning of  § 168(i)(9) after implementation of the new tax method of accounting.
- 4) For any public utility property within the meaning of  § 168(i)(10) and subject to Taxpayer's Consent Agreement, the ADIT resulting from the repair-related  § 481(a) adjustment is not subject to the normalization method of accounting within the meaning of  § 168(i)(9).
- 5) The ADIT resulting from expenditures (1) related to an item of property includible in rate

base and recoverable as regulatory depreciation expense in the determination of the revenue requirement set in the Surcharge Case and (2) deducted as repairs under  § 162 to public utility property within the meaning of  § 168(i)(10), or a predecessor provision of the normalization requirements, pursuant to the tax method of accounting for repairs permitted in Taxpayer's Consent Agreement, is not subject to the normalization method of accounting within the meaning of  § 168(i)(9) or, as applicable, a predecessor statutory provision.


6) The ADIT resulting from book/tax differences related to depreciable method and life for public utility property that exists at the date of a retirement of the property for regulatory accounting purposes in a transaction involving a replacement or relocation that is not treated as a disposition under Taxpayer's tax method of accounting for dispositions permitted in Taxpayer's Consent Agreement remains subject to the normalization method of accounting within the meaning of  § 168(i)(9) after the book-only retirement.


7) For any public utility property within the meaning of  § 168(i)(10) for which a disposition had been recognized for tax purposes in a tax year prior to the tax year of change for the changes in tax method of accounting subject to Taxpayer's Consent Agreement and for which the taxable gain or loss upon such disposition was reversed as part of the disposition-related  § 481(a) adjustment, the ADIT related to the restored tax basis of such public utility property is subject to the normalization method of accounting within the meaning of  § 168(i)(9), despite the book-only retirement.


8) If the Service rules as Taxpayer has requested with respect to issue # 5 and holds that ADIT resulting from repair-related book/tax differences is not subject to the normalization requirements, Taxpayer requests that the Service also rule: In order to comply with the normalization method of accounting within the meaning of  § 168(i)(9), the amount of depreciation-related ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case is limited to the amount of depreciation-related deferred tax expense recovered in rates as of the Surcharge Case rate base determination date.

9) If the Service rules as Taxpayer has requested with respect to issue # 5 and holds that ADIT resulting from repair-related book/tax differences is not subject to the normalization requirements, Taxpayer requests that the Service also rule: Under the circumstances described above, in order to comply with the normalization method of accounting within the meaning of  § 168(i)(9), the amount of depreciation-related ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case must be decreased to reflect a portion of the NOL for the test period for the Surcharge Case which would not have arisen had Taxpayer not reported depreciation-related book/tax differences during the test period for the Surcharge Case and such decrease in depreciation-related ADIT must be an amount that is no less than the amount computed using the With-and-Without Method.




10) If the Service (a) rules as Taxpayer has requested with respect to issue # 5 and holds

that ADIT resulting from repair-related book/tax differences is not subject to the normalization requirements, but (b) does not grant ruling # 9 in accordance with Taxpayer's analysis, Taxpayer requests that the Service instead rule: Under the circumstances described above, in order to comply with the normalization method of accounting within the meaning of  § 168(i)(9), the amount of depreciation-related ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case must be decreased to reflect a portion of the NOLC which would not have arisen (or an increase in such NOLC which would not have arisen) had Taxpayer not reported depreciation-related book/tax differences during the test period for the Surcharge Case and such decrease in depreciation-related ADIT must be an amount that is no less than the amount computed using the With-and-Without Method but only to the extent that the NOLC has not reduced depreciation-related ADIT in rate base computation in another rate proceeding with prices still in effect.


11) If the Service rules as Taxpayer has requested with respect to issue # 5 and holds that ADIT resulting from repair-related book/tax differences is not subject to the normalization requirements, Taxpayer requests that the Service also rule: Under the circumstances described above, in order to comply with the normalization method of accounting within the meaning of  § 168(i)(9), it is not necessary to decrease ADIT or otherwise increase rate base for the Surcharge Case by the portion of the NOLC which would not have arisen (or an increase in such NOLC which would not have arisen) had Taxpayer not reported depreciation-related book/tax differences in prior periods or during the test period for the Surcharge Case with respect to public utility property with rates not set by the Surcharge Case.










12) If the Service does not rule as Taxpayer has requested with respect to issue # 5 and holds that ADIT resulting from repair-related book/tax differences is subject to the normalization requirements, Taxpayer requests that the Service also rule: Under the circumstances described above, in order to comply with the normalization method of accounting within the meaning of  § 168(i)(9), the amount of ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case must be decreased to reflect the portion of the Surcharge Case test period NOL which would not have arisen had Taxpayer not reported the depreciation-related book/tax difference or repair-related book/tax difference permitted in Taxpayer's Consent Agreement with respect to expenditures with ratemaking determined pursuant to the Surcharge Case, by an amount that is no less than the amount computed using the With-and-Without Method. If, instead, the Service rules as Taxpayer has requested with respect to issue # 5, ruling request # 12 would be moot.





LAW AND ANALYSIS





 Section 168(f)(2) provides that the depreciation deduction determined under  § 168 shall not apply to any public utility property (within the meaning of  § 168(i)(10)) if the taxpayer does not use


a normalization method of accounting.




 Section 168(i)(10) defines, in part, public utility property as property used predominantly in the trade or business of the furnishing or sale of electrical energy if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof.






Prior to the Revenue Reconciliation Act of 1990, the definition of public utility property was contained in  § 167(l)(3)(A) and  § 168(i)(10), which defined public utility property by means of a cross reference to  § 167(l)(3)(A). The definition of public utility property is unchanged.  Section 1.167(l)-1(b) provides that under  § 167(l)(3)(A), property is public utility property during any period in which it is used predominantly in a  § 167(l) public utility activity. The term " section 167(l) public utility activity" means, in part, the trade or business of the furnishing or sale of electrical energy if the rates for such furnishing or sale, as the case may be, are regulated, i.e., have been established or approved by a regulatory body described in  § 167(l)(3)(A). The term "regulatory body described in  § 167(l)(3)(A)" means a State (including the District of Columbia) or political subdivision thereof, any agency or instrumentality of the United States or a public service or public utility commission or other body of any State or political subdivision thereof similar to such a commission. The term "established or approved" includes the filing of a schedule of rates with a regulatory body which has the power to approve such rates, though such body has taken no action on the filed schedule or generally leaves undisturbed rates filed by the taxpayer.





The definitions of public utility property contained in  § 168(i)(10) and former  § 46(f)(5) are essentially identical.  Section 1.167(l)-1(b) restates the statutory definition providing that property will be considered public utility property if it is used predominantly in a public utility activity and the rates are regulated.  Section 1.167(l)-1(b)(1) provides that rates are regulated for such purposes if they are established or approved by a regulatory body. The terms established or approved are further defined to include the filing of a schedule of rates with the regulatory body that has the power to approve such rates, even if the regulatory body has taken no action on the filed schedule or generally leaves undisturbed rates filed.




The regulations under former  § 46, specifically  § 1.46-3(g)(2), expand the definition of regulated rates. The expanded definition embodies the notion of rates established or approved on a rate of return basis. This notion is not specifically provided for in the regulations under former  § 167. Nevertheless, there is an expressed reference to rate of return in  § 1.167(l)-1(h)(6)(i). The operative rules for normalizing timing differences relating to use of different methods and periods of depreciation are only logical in the context of rate of return regulation. The normalization method, which



must be used for public utility property to be eligible for the depreciation allowance available under  § 168, is defined in terms of the method the taxpayer uses in computing its tax expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account. Thus, for purposes of applying the normalization rules, the definition of public utility property is the same for purposes of the investment tax credit and depreciation.

 Section 168(f)(2) of the Code provides that the depreciation deduction determined under  § 168 shall not apply to any public utility property (within the meaning of  § 168(i)(10)) if the taxpayer does not use a normalization method of accounting.


In order to use a normalization method of accounting,  § 168(i)(9)(A)(i) requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under  § 168(i)(9)(A)(ii), if the amount allowable as a deduction under  § 168 differs from the amount that would be allowable as a deduction under  § 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under  § 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.






 Section 168(i)(9)(B)(i) provides that one way the requirements of  § 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under  § 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under  § 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base (referred to as the "Consistency Rule").





Former  § 167(l) generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former  § 167(l)(3)(G) in a manner consistent with that found in  § 168(i)(9)(A).



 Section 1.167(l)-1(a)(1) provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under  § 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of



establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.




 Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.

 Section 1.167(l)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a subsection  (1) method for purposes of determining the taxpayer's reasonable allowance under  § 167(a) results in a net operating loss carryover to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under  § 167(a) using a subsection  (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.





 Section 1.167(l)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under  § 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under  § 1.167(l)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under  § 167(a).


 Section 1.167(l)-1(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under  § 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.



 Section 1.167(l)-1(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under  § 1.167(l)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

 Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so.  Section 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. 






Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.


 Section 1.167(l)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements of former  § 167(l) with respect to public utility property defined in former  § 167(l)(3)(A) pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under  § 167 and the use of straight line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account.


 Section 481(a) requires those adjustments necessary to prevent amounts from being duplicated or omitted to be taken into account when a taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year. See also § 2.05(1) of Rev. Proc. 97-27, 97-27, 1997-1 C.B. 680 (the operative method change revenue procedure at the time Taxpayer filed its Form 3115, *Application for Change in Accounting Method*).

An adjustment under  § 481(a) can include amounts attributable to taxable years that are closed by the period of limitation on assessment under  § 6501(a). *Suzy's Zoo v. Commissioner*, 114 T.C. 1, 13 (2000), *aff'd*, 273 F.3d 875, 884 [88 AFTR 2d 2001-6916] (9th Cir. 2001); *Superior Coach of Florida*,


Inc. v. Commissioner, 80 T.C. 895, 912 (1983), *Weiss v. Commissioner*, 395 F.2d 500 [22 AFTR 2d 5013] (10th Cir. 1968), *Spang Industries, Inc. v. United States*, 6 Cl. Ct. 38, 46 [54 AFTR 2d 84-5873] (1984), *rev'd on other grounds* 791 F.2d 906 [58 AFTR 2d 86-5052] (Fed. Cir. 1986). *See also* *Mulholland v. United States*, 28 Fed. Cl. 320, 334 [71 AFTR 2d 93-1916] (1993) (concluding that a court has the authority to review the taxpayer's threshold selection of a method of accounting *de novo*, and must determine, *ab initio*, whether the taxpayer's reported income is clearly reflected).




 Sections 481(c) and  1.481-4 provide that the adjustment required by  § 481(a) may be taken into accounting in determining taxable income in the manner, and subject to the conditions, agreed to by the Service and a taxpayer.  Section 1.446-1(e)(3)(i) authorizes the Service to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with  § 446(e). *See also* § 5.02 of Rev. Proc. 97-27.




When there is a change in method of accounting to which  § 481(a) is applied, § 2.05(1) of Rev. Proc. 97-27 provides that income for the taxable year preceding the year of change must be determined under the method of accounting that was then employed, and income for the year of change and the following taxable years must be determined under the new method of accounting as if the new method had always been used.


Regarding ruling requests 1 and 2, the key factors in determining whether property is public utility property are that (1) the property must be used predominantly in the trade or business of the furnishing or sale of, inter alia, water and wastewater; (2) the rates for such furnishing or sale must be established or approved by a State or political subdivision thereof, any agency or instrumentality of the United States, or by a public service or public utility commission or similar body of any State or political subdivision thereof; and (3) the rates so established or approved must be determined on a rate-of-return basis. State B statutes and Commission B rules provide eligible water corporations with the ability to recover certain infrastructure system replacement costs outside of a formal rate case filing via a Surcharge. These infrastructure system replacements will be predominantly used in the trade or business of the furnishing or sale of water and wastewater and therefore, it will possess the first of the three characteristics. Moreover, as a regulated public utility subject to the jurisdiction of federal or state law, including the ratemaking jurisdiction of the State B commission, the second requirement is met. Lastly, as evidenced by the facts, these rates are determined on a rate-of-return basis. After establishing that this involves public utility property, the law makes clear that the depreciation deduction determined under  § 168 shall not apply to any public utility property if the taxpayer does not use a normalization method of accounting. The normalization regulations require a taxpayer to credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account.


Taxpayer's ruling request 3 pertains to the depreciation-related ADIT existing prior to the year of



change ([Redacted Text]) for public utility property in service as of the end of the taxable year immediately preceding the year of change. Beginning with the year of change, the [Redacted Text] Consent Agreement granted Taxpayer permission to change its (1) method of accounting for costs to repair and maintain tangible property from capitalizing and depreciating these costs to deducting these costs under  § 162, and (2) unit of property for determining dispositions of depreciable network assets from using a method other than the functional interdependence test to using the functional interdependence test to determine the units of property.

As stated previously, condition nine of the [Redacted Text] Consent Agreement provides that if any item of property subject to the Form 3115 is public utility property within the meaning of  § 168(i)(10), a normalization method of accounting (within the meaning of  § 168(i)(9)) must be used for such public utility property. Public utility property (within the meaning of  § 168(i)(10)) is a depreciable asset. Consequently, condition nine of the [Redacted Text] Consent Agreement is intended to apply to Taxpayer's public utility property that continues to be depreciated for federal income tax purposes under Taxpayer's new method of accounting for the year of change and subsequent taxable years.

When there is a change in method of accounting to which  § 481(a) is applied, income for the taxable year preceding the year of change must be determined under the method of accounting that was then employed by Taxpayer, and income for the year of change and the following taxable years must be determined under Taxpayer's new method of accounting as if the new method had always been used. See  § 481(a);  § 1.481-1(a)(1); and § 2.05(1) of Rev. Proc. 97-27. In other words:

- (1) Taxpayer's new method of accounting is implemented beginning in the year of change;
- (2) Taxpayer's old method of accounting used in the taxable years preceding the year of change is not disturbed; and
- (3) Taxpayer takes into account a  § 481(a) adjustment in computing taxable income to offset any consequent omissions or duplications.


Accordingly, for public utility property in service as of the end of the taxable year immediately preceding the year of change ([Redacted Text]), the depreciation-related ADIT existing prior to the year of change for the changes in methods of accounting subject to the [Redacted Text] Consent Agreement does not remain subject to the normalization method of accounting within the meaning of  § 168(i)(9) after implementation of the new tax methods of accounting in the year of change and subsequent taxable years.



As stated previously under ruling request 3, condition nine of the [Redacted Text] Consent Agreement is intended to apply to Taxpayer's public utility property that continues to be depreciated for federal income tax purposes under Taxpayer's new method of accounting for the year of change and subsequent taxable years. A repair expense is an item of expense that is deductible under  § 162 and for which depreciation is not allowable. Accordingly, the ADIT resulting from the repair-related 

§ 481(a) adjustment is not subject to the normalization method of accounting within the meaning of § 168(i)(9).


Similarly, condition nine of the [Redacted Text] Consent Agreement is intended to apply to Taxpayer's public utility property that continues to be depreciated for federal income tax purposes under Taxpayer's new method of accounting for the year of change and subsequent taxable years. A repair expense is an item of expense that is deductible under § 162 and for which depreciation is not allowable. Accordingly, ADIT resulting from expenditures (1) related to an item of property includible in rate base and recoverable as regulatory depreciation expense in the determination of the revenue requirement set in the Surcharge Case and (2) deducted as repairs under § 162 to public utility property within the meaning of § 168(i)(10), or a predecessor provision of the normalization requirements, pursuant to the tax method of accounting for repairs permitted in Taxpayer's Consent Agreement, is not subject to the normalization method of accounting within the meaning of § 168(i)(9) or, as applicable, a predecessor statutory provision.



Regarding ruling request 6, § 1.167(l)-1(a)(1) provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under § 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Section 1.167(l)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under § 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under § 1.167(l)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under § 167(a). In this case, the transaction involves a replacement or relocation that is not treated as a disposition under Taxpayer's tax method of accounting. The depreciation-related ADIT existing immediately prior to a transaction considered a retirement for regulatory accounting purposes but not treated as a disposition for federal income tax purposes continues to be subject to the normalization requirements because adjusted tax basis is not

affected and the  § 168(a) depreciation deductions continue.

For ruling request 7, as stated previously under ruling request 3, condition nine of the [Redacted Text] Consent Agreement is intended to apply to Taxpayer's public utility property that continues to be depreciated for federal income tax purposes under Taxpayer's new method of accounting for the year of change and subsequent taxable years. Accordingly, the ADIT resulting from the disposition-related  § 481(a) adjustment and related to the restored tax basis of public utility property that was treated as disposed under the old method of accounting but is not treated as disposed under the new method of accounting is subject to the normalization method of accounting within the meaning of  § 168(i)(9).

Regarding ruling requests 8, 9, and 11, generally, Taxpayer is arguing that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax during the Surcharge Case test period due to the presence of the NOLC. The normalization requirements pertain only to deferred income taxes for public utility property resulting from the use of accelerated depreciation for tax purposes and the use of straight-line depreciation for establishing cost of service and reflecting the operating results in regulated books of account. Generally, amounts that do not actually defer tax because of the existence of an NOL need to be reflected as offsetting entries to the ADIT account to show the portion of tax losses which did not actually defer tax due to accelerated depreciation.










 Section 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the reserve account for deferred taxes (ADIT), reduces rate base, it is clear that the portion of the net operating loss carryover (NOLC) that is attributable to accelerated depreciation must be taken into account in calculating the amount of the ADIT account balance. Thus, the ADIT asset resulting from the NOLC should be included in rate base, given the inclusion in rate base of the full amount of the ADIT liability resulting from accelerated tax depreciation.




 Section 1.167(l)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes.  Section 1.167(l)-1(h)(1)(iii) provides generally that, if, in respect of any year, the use of other than regulatory depreciation for tax purposes results in an NOLC carryover (or an increase in an NOLC which would not have arisen had the taxpayer claimed only regulatory depreciation for tax purposes), then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director. The "with or without" methodology suggested by Taxpayer is specifically designed to ensure that the portion of the


NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers.




Taxpayer also raises the issue of the computation of the amount by which depreciation-related Taxpayer's NOLC as of the rate base determination date for the Surcharge Case must be included in rate base. This focuses on whether the NOLC taken into account in the Surcharge Case is limited to depreciation-related book/tax differences related to expenditures reflected in the Surcharge Case or must also reflect the full net increase in depreciation-related NOLC occurring since the rate base determination date of the immediately preceding base rate proceeding. In this case, based on the State B statute, the revenue requirement of a Surcharge Case is limited to the following income tax amounts: ADIT associated with property-related costs for property with rates set by the Surcharge Case and income taxes applicable to the Surcharge Case revenue requirement. The normalization requirements do not require that all incremental NOLC arising since the most recent general rate proceeding must be reflected in an interim (here a Surcharge) proceeding. Instead, the normalization requirements permit an increase in NOLC resulting from non-Surcharge Case public utility property to be disregarded for the Surcharge Case and considered in the next rate proceeding that reflects the depreciation expense and rate base inclusion of the public utility property resulting in the depreciation-related book/tax differences included in the NOLC.


Based on the foregoing, we conclude that:


- 1) The property otherwise depreciable under  § 168(a) and for which cost recovery and return on investment initially occur as part of the Surcharge Case, rather than as part of base rates set in less frequent general rate case proceedings, constitutes public utility property within the meaning of  § 168(i)(10).
- 2) The ADIT amounts used in computing the revenue requirement set in the Surcharge Case with respect to public utility property within the meaning of  § 168(i)(10) must comply with the normalization method of accounting within the meaning of  § 168(i)(9).
- 3) For any public utility property within the meaning of  § 168(i)(10) of the Code as of the end of the tax year immediately preceding the year of change for the changes in tax method of accounting subject to Taxpayer's Consent Agreement, the depreciation-related ADIT prior to the change in tax method of accounting for repairs and dispositions is not subject to the normalization method of accounting within the meaning of  § 168(i)(9) of the Code after implementation of the new tax method of accounting.
- 4) For any public utility property within the meaning of  § 168(i)(10) and subject to Taxpayer's Consent Agreement, the ADIT resulting from the repair-related  § 481(a) adjustment is not subject to the normalization method of accounting within the meaning of  § 168(i)(9).

5) The ADIT resulting from expenditures (1) related to an item of property includible in rate base and recoverable as regulatory depreciation expense in the determination of the revenue requirement set in the Surcharge Case and (2) deducted as repairs under  § 162 to public utility property within the meaning of  § 168(i)(10), or a predecessor provision of the normalization requirements, pursuant to the tax method of accounting for repairs permitted in Taxpayer's Consent Agreement, is not subject to the normalization method of accounting within the meaning of  § 168(i)(9) or, as applicable, a predecessor statutory provision.


6) The ADIT resulting from book/tax differences related to depreciable method and life for public utility property that exists at the date of a retirement of the property for regulatory accounting purposes in a transaction involving a replacement or relocation that is not treated as a disposition under Taxpayer's tax method of accounting for dispositions permitted in Taxpayer's Consent Agreement remains subject to the normalization method of accounting within the meaning of  § 168(i)(9) after the book-only retirement.

7) For any public utility property within the meaning of  § 168(i)(10) for which a disposition had been recognized for tax purposes in a tax year prior to the tax year of change for the changes in tax method of accounting subject to Taxpayer's Consent Agreement and for which the taxable gain or loss upon such disposition was reversed as part of the disposition-related  § 481(a) adjustment, the ADIT related to the restored tax basis of such public utility property is subject to the normalization method of accounting within the meaning of  § 168(i)(9), despite the book-only retirement.

8) In order to comply with the normalization method of accounting within the meaning of  § 168(i)(9), the amount of depreciation-related ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case is limited to the amount of depreciation-related deferred tax expense recovered in rates as of the Surcharge Case rate base determination date.

9) Under the circumstances described, in order to comply with the normalization method of accounting within the meaning of  § 168(i)(9), the amount of depreciation-related ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case must be decreased to reflect a portion of the NOL for the test period for the Surcharge Case which would not have arisen had Taxpayer not reported depreciation-related book/tax differences during the test period for the Surcharge Case and such decrease in depreciation-related ADIT must be an amount that is no less than the amount computed using the With-and-Without Method.


10) Ruling request 10 is moot because we grant ruling 9 in accordance with Taxpayer's analysis.

11) Under the circumstances described above, in order to comply with the normalization method of accounting within the meaning of  § 168(i)(9), it is not necessary to decrease

ADIT or otherwise increase rate base for the Surcharge Case by the portion of the NOLC which would not have arisen (or an increase in such NOLC which would not have arisen) had Taxpayer not reported depreciation-related book/tax differences in prior periods or during the test period for the Surcharge Case with respect to public utility property with rates not set by the Surcharge Case.

12) Ruling request 12 is moot because we rule as Taxpayer requests with respect to ruling request 5.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal income tax consequences of the above described facts under any other provision of the Code or regulations.

This ruling is directed only to the taxpayer requesting it.  Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

This ruling is based upon information and representations submitted by Taxpayer and accompanied by penalty of perjury statements executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Patrick S. Kirwan

Chief, Branch 6

Office of Associate Chief Counsel

(Passthroughs & Special Industries)


	<u>Description</u>	Pro Forma Adjustments		
		<u>Account</u>	<u>Debit</u>	<u>Credit</u>
		<u>Total Company</u>		
1	<u>2017 - Pre TCJA</u>			
	Deferred Tax Liability - Accelerated Depreciation	2821001	191,903,511	
	Debt/Equity			191,903,511
		Entry to reflect total company NOL as of 12.31.17		
2	<u>2017 - Post TCJA</u>			
	Regulatory Asset - Protected	2544001	76,761,405	
	Deferred Tax Liability	2824001		77,108,409
	Regulatory Asset - Unprotected	2544001		(347,005)
	Regulatory Asset	2544001	20,572,056	
	DTL - Regulatory Asset	1904001		20,572,056
		Entry to reflect remeasurement of NOL and corresponding		
3	<u>2018 thru 2022 Forecast Activity</u>			
	Deferred Tax Liability - Accelerated Depreciation	2821001		37,070,925
	Debt/Equity		37,070,925	
		Entry to recognize NOL utilized 2018 thru end of test period		
4	<u>Adjustment to Test Year Protected Amortization</u>			
	Regulatory Asset - Protected	2544001		481,297
	Deferred Income Tax Expense	4101001	481,297	
	Deferred Tax Liability	2821001		481,297
	Deferred Tax Liability	2824001	481,297	
	Regulatory Asset - Protected	2544001		128,988
	Deferred Tax Asset	1904001	128,988	
		Entry to reflect reduced Amortization of Protected Excess for		
5	<u>Adjustment to Pre-Test Year Amortization</u>			
	Regulatory Asset - Protected	2544001		592,536
	Deferred Income Tax Expense	4101001	592,536	
	Deferred Tax Liability	2821001		592,536
	Deferred Tax Liability	2824001	592,536	
	Regulatory Asset - Protected	2544001		158,800
	Deferred Tax Asset	1904001	158,800	
		Entry to reflect reduced Amortization of Protected Excess for		
Total Net Operating Loss			154,832,587	
Total Company Adjustment to Test Year Protected Amortization			481,297	
Total Company to Provision for Refund			1,073,834	

AFFIDAVIT OF DAVID A. HODGSON

STATE OF OHIO)

COUNTY OF FRANKLIN)


On the 26th day of April 2021, before me appeared David A. Hodgson to me personally known, who, being by me first duly sworn, states that he is a Tax Accounting & Regulatory Support Manager for American Electric Power Service Corporation and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.


Signed on 2021/04/26 07:37:44 -8:00

David A. Hodgson

Subscribed and sworn to before me this 26th day of April, 2021.




Signed on 2021/04/26 07:37:44 -8:00

Notary Public

My commission expires: April 29, 2024

