Internal Revenue Service

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Department of the Treasury
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Person To Contact:
, ID No.
Telephone Number:

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Date:
October 24, 2022

Re:

LEGEND:

Taxpayer	=
State A	=
State B	=
State C	=
State D	=
State E	=
State F	=
Company	=
County	=
Subsidiary 1	=
Subsidiary 2	=
Subsidiary 3	=
Subsidiary 4	=
Subsidiary 5	=
Subsidiary 6	=
a	=
b	=
c	=
d	=
e	=
Commission A	=
Commission B	=
Date 1	=

Dear :

This letter responds to your letter, dated May 10, 2022, submitted by your authorized representative, requesting a ruling concerning the applicability of the normalization provisions under § 1.168(i)-3(a) of the Income Tax Regulations.

FACTS

Taxpayer owns natural gas distribution and transmission subsidiaries that operate in State A, State B, State C, State D, State E, and State F. Taxpayer provides safe, clean and affordable natural gas to businesses and residents in a states through Subsidiary 1, Subsidiary 2, Subsidiary 3, Subsidiary 4, Subsidiary 5, and Subsidiary 6. Taxpayer's subsidiaries serve approximately b customers and operate more than c miles of pipeline.

On Date 1, Subsidiary 5 and Subsidiary 6 (the "purchasers") acquired through an asset purchase agreement certain gas distribution assets of Company. The purchasers acquired from Company the assets and other rights necessary for the operations of Company's natural gas distribution systems in State A, State E, and certain portions of County.

In order to acquire the assets from Company, Taxpayer and Company had to seek approval from Commission A and Commission B. Although both commissions ultimately approved the acquisition, as part of a settlement agreement approved in the final order, Commission B required Taxpayer to obtain a private letter ruling from the IRS to determine the appropriate treatment of the acquired protected excess deferred income taxes (EDIT). Pursuant to the parties' settlement agreement, the request for a private letter ruling would be submitted within d days following the transaction closing.

Pursuant to section 13001(d) of Public Law No. 115-97, 131 Stat. 2054 (2017) more commonly referred to as the Tax Cuts and Jobs Act (TCJA), Company established protected EDIT reserves based on the remeasurement of protected method and life depreciation differences between tax and regulatory books. These reserves were amortized using the prescribed Average Rate Assumption Method (ARAM) detailed in section 13001(d) of the TCJA. Taxpayer assumed the regulatory liability representing the protected EDIT liability of Company, which amounted to approximately $e, as part of the asset acquisition.

RULING REQUESTED

Taxpayer requests a ruling as to whether the acquired regulatory liability associated with the "protected" excess deferred income taxes or excess tax reserve included in the asset purchase agreement of certain gas distribution assets will continue to be protected by the normalization rules following the acquisition.

LAW AND ANALYSIS

Section 168 of the Internal Revenue Code generally allows taxpayers to compute their depreciation deduction for federal income tax purposes under the accelerated cost recovery system. Section 168(f)(2) of the Internal Revenue Code (Code), provides that the depreciation deduction determined under § 168 of the Code 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. This reserve is referred to as the Accumulated Deferred Income Taxes (ADIT) reserve. Taxpayers calculate the amount of the adjustments to the ADIT reserve by reference to the corporate tax rate applicable in each year that the depreciation deduction allowable as a deduction under § 168 exceeds the amount calculated under § 168(i)(9)(A)(i) for the taxpayer's regulated tax expense.

Section 1.167(l)-1(h)(2)(i) of the Income Tax Regulations 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 and included in such reserve under § 167(l) “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” under § 1.167(l)-1(h)(1)(i). That section notes that, additionally, the aggregate amount allocable to deferred taxes may be properly adjusted to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under § 167(a). Consequently, the ADIT increases in each year the accelerated depreciation under § 168 exceeds the tax depreciation amount used for calculating the taxpayer's regulated tax expense and the ADIT decreases in each year the accelerated depreciation under §168 is less than the tax depreciation amount used for calculating the taxpayer's regulated tax expense. These increases and decreases are measured by the differences in the two depreciation methods multiplied by the tax rate in effect for the year of the adjustment to the ADIT.

The TCJA, enacted on December 22, 2017, generally reduced the corporate tax rate under § 11 from 35 percent to 21 percent for taxable years beginning after December 31, 2017. Section 13001(a) of the TCJA. Because of the reduction in rates, for property subject to depreciation in a taxable year beginning on or before December 31, 2017, and not yet fully depreciated in the first taxable year beginning after December 31, 2017, a portion of the ADIT reserve will reflect this reduction. The portion of the ADIT reserve that reflects the difference in tax rates due to accelerated depreciation is referred to as the Excess Tax Reserve (ETR). The ETR represents the amount by which the ADIT reserve exceeds the amount it would have contained had the reduction in rates been in effect for every year the property was subject to depreciation. That is, the ETR is the amount of accelerated depreciation-related taxes that have been collected from ratepayers but have not yet been paid by the utility and become excess due to the reduction in rates.

Section 13001(d) of the TCJA includes accompanying but uncodified normalization requirements related to the reduction of the corporate tax rate. Section 13001(d)(1) provides that "[a] normalization method of accounting shall not be treated as being used with respect to any public utility property for purposes of [§§ 167 or 168] if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method" (ARAM).

Section 13001(d)(2) of the TCJA provides an alternative method for certain taxpayers. If, as of the first day of the taxable year that includes the date of enactment of the TCJA, the taxpayer was required by a regulatory agency to compute depreciation for public utility property on the basis of an average life or composite rate method, and the taxpayer's books and underlying records did not contain the vintage account data necessary to apply ARAM, the taxpayer will be treated as using a normalization method of accounting if, with respect to such jurisdiction, the taxpayer uses the alternative method for public utility property that is subject to the regulatory authority of that jurisdiction. Section 13001(d)(3)(C) of the TCJA defines the "alternative method" as the method in which the taxpayer computes the ETR on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation for regulatory purposes, and reduces the ETR ratably over the remaining regulatory life of the property.

Section 4.01 of Rev. Proc. 2020-39, 2020-36 I.R.B. 609, provides that under section 13001(d)(1) of the TCJA, taxpayers must use ARAM to calculate the reversal of their ETR if the taxpayer's regulatory books (the financial and tax information used by their regulator in setting rates which may include but is not limited to materials submitted to public service commissions as well as any supporting materials) are based upon the vintage account data necessary to use ARAM. However, if the taxpayer's regulatory books are not based upon the vintage account data that is necessary for the ARAM, use of the ARAM is not required.

Section 1.168(i)-3(a) provides rules for the application of section 203(e) of the Tax Reform Act of 1986, Public Law 99-514 (100 Stat. 2146) to a taxpayer with respect to public utility property (within the meaning of section 168(i)(10)) that ceases, whether by disposition, deregulation, or otherwise, to be public utility property with respect to the taxpayer and that is not described in § 1.168(i)-3(a)(2) (deregulated public utility property).

Under § 1.168(i)-3(b), if public utility property of a taxpayer becomes deregulated public utility property to which this section applies, the reduction in the taxpayer's ETR permitted under section 203(e) of the Tax Reform Act of 1986 is equal to the amount by which the reserve could be reduced under that provision if all such property had remained public utility property of the taxpayer and the taxpayer had continued use of its normalization method of accounting with respect to such property.

Section 1.168(i)-3(a)(2)(ii) provides an exception to the rule under § 1.168(i)-3(b) for property transferred by a taxpayer if after the transfer, the property is public utility property of the transferee and the taxpayer's ETR with respect to the property (within the meaning of section 203(e) of the Tax Reform Act of 1986) is treated as an ETR of the transferee with respect to the property.

Section 4.01 of Rev. Proc. 2020-39, provides that under section 13001(d)(1) of the TCJA, taxpayers must use ARAM to calculate the reversal of their ETR, if the taxpayer's regulatory books are based upon the vintage account data necessary to use ARAM. However, if the taxpayer's regulatory books are not based upon the vintage account data that is necessary for the ARAM, use of the ARAM is not required. Section 4.02 of Rev. Proc. 2020-39 provides that the determination of whether a taxpayer's regulatory books contain sufficient vintage account data necessary to use the ARAM is determined based on all the facts and circumstances. Under section 5 of Rev. Proc. 2020-39, the TCJA ETR normalization requirements are part of the overall pre-existing deferred tax normalization rules. The revenue procedure is intended to be consistent with those rules.

Section 4.03 of Rev. Proc 2020-39 provides that the rules in § 1.168(i)-3, apply only to section 203(e) of the Tax Reform Act of 1986. Generally, the IRS will apply § 1.168(i)-3 as if that limitation date language is not present. Thus, the sharing of ETRs with customers continues to be permitted in most circumstances after a retirement or disposition and upon the sale of public utility property to another regulated utility as set forth in § 1.168(i)-3.

The exception under § 1.168(i)-3(a)(2)(ii) applies if the transferor’s ETR is treated as an ETR of the transferee. Accordingly, Taxpayer’s acquired regulatory liability associated with the “protected” excess deferred income taxes or ETR included in the asset purchase agreement of certain gas distribution assets will continue to be protected under the normalization rules if the ETR in the hands of the Taxpayer is

treated in accordance with Rev. Proc. 2020-39 using the same schedule previously used by Company.

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.

This letter is being issued electronically in accordance with Rev. Proc. 2020-29, 2020-21 I.R.B. 859. A paper copy will not be mailed to Taxpayer.

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,

David Selig
Senior Counsel, Branch 6
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure:
Copy for § 6110 purposes

cc: