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Legend:

Parent =

Taxpayer =

Additional Subsidiary =

Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Date 8 =
Date 9 =
Date 10 =
Commission A =
Commission B =

Staff =
a =
b =
c =
d =
e =
f =

g	=	
Year 1	=	
State	=	
System	=	
Form	=	
Form A	=	
Form B	=	
Rules	=	
Enforcement Matter	=	
Agency	=	
Opinion	=	

Dear :

On Date 1, on behalf of Parent and its wholly-owned subsidiary, Taxpayer, Parent's and Taxpayer's authorized representatives requested rulings under § 168(i)(9) regarding the potential implementation of a proposed ratemaking adjustment under the depreciation normalization provisions of the Internal Revenue Code of 1986, as amended ("Code") and the regulations thereunder. Taxpayer's request is made pursuant to, and in compliance with, Rev. Proc. 2022-1. Parent is simultaneously submitting a substantially identical letter ruling for another of its wholly-owned subsidiaries, Additional Subsidiary.

On Date 2, the Staff filed a written submission with the Internal Revenue Service, objecting to certain statements set forth in the Statement of Facts of the Date 1 submission that it believed were erroneous or potentially misleading. Parent and Taxpayer did not agree with the concerns but on Date 3, modified and resubmitted the ruling request with a modified Statement of Facts that addresses the Staff's stated factual concerns. In addition, Staff believed that the summaries of its position in the original ruling request submission did not adequately capture the entirety of its legal positions and analysis. Accordingly, Taxpayer's representatives removed its summaries of the Staff's positions and analyses from the ruling request and are willing for the Staff's positions and analyses reflected in its Date 2 submission to speak for themselves. Additionally, Staff submitted an addendum dated Date 4 to its original Date 2 filing attached to the Date 3 submission by Taxpayer. Later, in response to a request for additional information, Taxpayer submitted additional responses on Date 5.

Parent**,** through its operating subsidiaries, serves nearly a customers in b states. Taxpayer, a wholly owned subsidiary of Parent, is a regulated public utility serving more than c customers in d states. As a member of the Parent affiliated group, Taxpayer joins in the filing of a consolidated return with other Parent operating companies. As is relevant to this private letter ruling request, Taxpayer is subject to the ratemaking jurisdiction of Commission A.

Parent and each of its subsidiaries are accrual basis taxpayers. Parent is the common parent of an affiliated group of corporations filing a consolidated return on a calendar-year basis. Parent, as the common parent of the affiliated group, serves as the agent of Taxpayer for purposes of this private letter ruling request pursuant to § 1.1502-77(a) of the Income Tax Regulations.

On a separate return basis, Taxpayer had a federal income tax net operating loss carry-forward ("NOLC"). In its rate case filing in the instant case, Taxpayer reflected a total NOLC deferred tax asset ("DTA") attributable to tax losses for the years Year 1 through the Date 6 test year end by proposing an adjustment to its actual Generally Accepted Accounting Principles (GAAP) and Commission B books of account.

Under the Parent Tax Allocation Agreement ("TAA") amongst the Parent affiliated group members joining in the filing of a consolidated return, certain profitable members of the affiliated group were able to utilize the Taxpayer NOLC to offset their separate company taxable income. None of these profitable subsidiaries provided electric utility service to customers in State within the service territory of Taxpayer and their operations were either subject to the jurisdiction of Commission B and/or state public utility commissions other than Commission A, were separately subject to the jurisdiction of Commission A, or were unregulated businesses not subject to the jurisdiction of any public utility commission.

Pursuant to the TAA, the profitable members made cash payments to Parent for their separate return tax liability, and Parent remitted cash payments of $e to Taxpayer for the tax benefit derived by the affiliated group from the use of Taxpayer's losses. On its financial (GAAP) books and its annual and quarterly balance sheets reported on Commission B Form A and Form B, Taxpayer reduced its DTA for the NOLC to reflect the receipt of cash for the use of its loss by other members of the affiliated group, thereby recording an adjusted DTA balance of zero on its GAAP books. Similarly, in its annual reports filed with the Agency, the consolidated NOLC as of Date 6 and Date 7, reflected a balance of zero. In the rate base calculated for its General Rate Case ("GRC" filing), Taxpayer restored the DTA in order to reflect a separate return basis.

For ratemaking purposes, Taxpayer includes all used and useful public utility property in rate base, calculates depreciation expense thereon using a straight-line method, depreciates such property for federal income tax purposes using accelerated depreciation (MACRS), and makes an adjustment to the reserve for deferred taxes (at the statutory rate) to reflect the difference in tax liability attributable to the use of different depreciation methods for book and tax purposes. Tax expense for the test year of approximately $f was thus calculated on a fully-normalized basis to include both current and deferred taxes on a stand-alone basis unreduced for any NOL. All of these calculations were done on a separate return basis without regard to the property, tax attributes, or separate tax liability, of affiliates, or the non-State property of Taxpayer.

In accordance with section 13001 of Public Law 115-97, commonly referred to as the Tax Cuts and Jobs Act ("TCJA"), Taxpayer calculated its so-called excess deferred income taxes ("EDIT") as of December 31, 2017, representing the amount of accelerated depreciation-related taxes previously collected from customers that had not yet been paid by Taxpayer and became excess due to the reduction in tax rates in the TCJA. (Rev. Proc. 2020-39, Section 2.05.) The total EDIT so-calculated was based on the deferred tax balances on Taxpayer's actual financial (GAAP) books and as a result did not include any adjustment for the separate return NOLC DTA. Had the calculation of EDIT taken into account the separate return NOLC DTA, it would have resulted in a reduction to the balance of $g. Pursuant to TCJA § 13001(d)(1), Taxpayer began amortizing the unadjusted EDIT balance on its ratemaking books in accordance with the Average Rate Assumption Method ("ARAM") beginning as of January 1, 2018. In connection with the preparation of Taxpayer's current GRC, Taxpayer determined that amortization of its EDIT must take into account the $g related to the separate return NOLC DTA as a reduction to the total EDIT available to be amortized and seeks to correct such treatment prospectively in the current GRC, the "next available opportunity," pursuant to Section 4.01(6) of Rev. Proc. 2020-39.

In Taxpayer's current GRC, the Staff asserted that no DTA was allowable to Taxpayer because its GAAP books and Commission B Form A and Form B reflected a balance of zero. Staff's alternative positions are that if the DTA is restored to rate base, then either (i) the $e of used and useful property that Taxpayer purportedly acquired using the TAA payments should be removed from rate base, or (ii) the $e of TAA payments received by Taxpayer should be treated as additional zero-cost capital.

Taxpayer asserted that the adoption of Staff's proposal would violate the normalization rules of § 168(i)(9), and particularly the consistency rules of § 168(i)(9)(B). Specifically, Taxpayer contended that the adjustment to remove used and useful assets from rate base, while computing depreciation expense, tax expense and the reserve for deferred taxes by including such assets, would violate the consistency rules. Moreover, Taxpayer asserted that the Staff proposal would violate the deferred tax reserve computational rules of § 1.167(l)-1(h)(2) by introducing a variable, that is, the profits of affiliates and/or the TAA payments, other than the method and life differences between book and tax depreciation and the statutory tax rate. Finally, Taxpayer and Staff generally agreed that the proper treatment of Taxpayer's EDIT should be determined in the same manner as the resolution of the DTA issue.

The administrative law judges presiding over the GRC recommended that Commission A adopt Staff's position, and Taxpayer filed its exceptions to that recommendation. The parties appeared at an open Commission A hearing held on Date 8. Commission A issued a final order on Date 9 adopting Staff's position, but it is aware that Taxpayer is filing this private letter ruling request.

In Staff's submission dated Date 2, Staff allege that Taxpayer's ratemaking regulated books of account did not reflect the NOLC DTA balance unreduced by the TAA payments. Staff note that Taxpayer confirmed in response to a discovery request (answered as if under oath) that the balance of its NOLC DTA at the Date 10 test year end on its books and records kept in accordance with the Commission 2 System and reported on its Commission 2 Form for that date, was zero. Staff assert that Commission A's Rules require a major electric utility like Taxpayer to maintain, for purposes of accounting and reporting to Commission A, its books and records in accordance with the uniform system of accounts adopted and amended by Commission B for all regulatory purposes. The term "all regulatory purposes" includes ratemaking. Thus, Taxpayer's regulatory books and records for the Commission B and State jurisdictions are the same as its ratemaking books which reflected the NOLC DTA actual balance of zero at the end of the test year.

In response to these concerns raised by Commission A on its submission dated Date 2, Taxpayer explained more in its additional submission dated Date 5 that journal entries are not made to the financial statements of Taxpayer to re-establish the NOLC DTA for ratemaking purposes. Taxpayer says the tax allocation method utilized by the Parent group for financial reporting reflects the NOLC (and other tax attributes) as realized or realizable when it is realized or realizable by the consolidated group. Taxpayer represents that this methodology conforms to the requirements outlined by Commission B for financial accounting and reporting (Form A and Form B) in Enforcement Matter.

Taxpayer explains that the "separate return method" terminology used by Agency is a method of allocating taxes amongst the members of an affiliate group. This methodology allocates current and deferred taxes to members of the group as if it were a separate taxpayer.

Regarding Commission B Financial Reporting, Taxpayer explains that Commission B issued Enforcement Matter to discuss the acceptable accounting for income taxes, addressing both a "separate return method" and a "stand alone method" of accounting. Commission B describes the "separate return method" as a method that allocates current and deferred taxes to members of the group as if each member were a separate taxpayer, which is similar to the definition of separate return used by the Agency. Under the "separate return method," the sum of the individual member's allocations will not align with the consolidated tax return. In Enforcement Matter, Commission B also defines the "stand alone method" and distinguishes it from the "separate return method". The "stand alone method" allocates the consolidated group tax expense to individual members through the recognition of the benefits/burdens contributed by each member of the consolidated group to the consolidated return. Under this method, the sum of the amounts allocated to individual members equals the consolidated amount. Commission B concludes in Enforcement Matter that Commission B requires the use of the "stand alone method" and expressly provides that the use of the "separate return method" will not be permitted for Commission B financial accounting and reporting (Commission B Form A and Form B.)

Commission B has issued several decisions rejecting the use of the “separate return method” for determining income tax expense when an entity files as part of a consolidated group. Instead, Commission B relies on the “stand alone method” of allocating income taxes between members of a consolidated group. Under the “stand alone method,” the consolidated tax expense is allocated to individual members through recognition of the benefits/burdens contributed by each member of the consolidated group to the consolidated return. Under the “stand alone method,” the sum of amounts allocated to individual members equal the consolidated amount.

Regarding Commission B Ratemaking, Opinion from Commission B describes the "stand alone method" as an income tax allowance "that takes into account the revenues and costs entering into the regulated cost of service without increase or decrease for tax gains or losses related to other activities ... " The “stand alone method” results in the tax allowance being equal to the tax the utility would pay on the basis of its projected revenues less deductions for all operating, maintenance, and interest expenses included in the cost of service. Based on this definition, for ratemaking purposes, the Commission B-approved tax allocation method for ratemaking purposes aligns with the Agency definition of "separate return method" despite using the term "stand alone method" in that the tax expense is only attributable to the cost of service and the activities involved in providing service to a utility's customers.

The receipt of cash from the Taxpayer's Parent Company for the consolidated utilization of the NOL results in the DTA being reduced to zero on Commission B Form A and Form B. Journal entries are not made to the financial statements of the subsidiary to re-establish the NOLC DTA for ratemaking purposes. The tax allocation method utilized by the Parent group for financial reporting reflects the NOLC (and other tax attributes) as realized or realizable when it is realized or realizable by the consolidated group. This methodology conforms to the requirements outlined by Commission B for financial accounting and reporting (Form A and Form B) in Enforcement Matter.

Because no journal entries are recorded to the financial statements to re-establish the DTA, Taxpayer represents that it is necessary to make adjustments for ratemaking purposes in order to comply with the normalization rules. Accordingly, these adjustments are incorporated into the filing package presented to the respective state regulatory bodies as part of the Taxpayer's rate requests. The filing packages include schedules that start with the financial information on Commission B’s Form A and Form B and the financial information presented in Agency financial statements. Consistent with the “separate return methodology,” however, adjustments are made to align the rate request with the revenues and costs entering into the regulated cost of service. These adjustments are where the NOLC DTA is re-established as a component of accumulated deferred income taxes.

Taxpayer emphasizes the role that Commission B Form A and Form B play (and do not play) in the ratemaking context. Taxpayer asserts that Commission B Form A and Form B are simply the starting point for the financial data included in ratemaking. Adjustments are then made to arrive at the end result of a tax allowance for the test year associated with the provision of utility service to the regulatory jurisdiction's customers. The financial statement data in Commission B Form A and Form B are first adjusted to remove items of income and expense that are not associated with the provision of utility service. An example of one of these items is the expense in the financial statements for lobbying which is removed along with the income tax associated with that expense. In addition to the adjustments to remove non-utility activity, there are also adjustments that are made to the Commission B Form A and Form B financial statements for ratemaking purposes. An example of these ratemaking adjustments is changes to payroll expenses for known increases/decreases in the expense relative to the expense reported on the Commission B Form A and Form B. After these adjustments are made, a further adjustment is made to the income and expense to allocate it to the customers within the respective regulatory jurisdiction to which the filing is being made.

Per Commission B's guidance in Opinion, Taxpayer asserts that the income tax allowance in ratemaking should reflect the tax the utility would pay on the basis of its projected revenues less deductions for all operating, maintenance, and interest expenses included in the cost of service. Taxpayer asserts this ratemaking aligns with the consistency requirement set forth in § 168(i)(9) such that any projections of tax expense, depreciation expense, rate base and the deferred tax reserve remain in synch. Taxpayer believes that setting rates based on the unadjusted Commission B financial statements would violate the consistency requirement of the normalization rules.

RULINGS REQUESTED

Taxpayer requests the following rulings:

1. The implementation of Staff's proposal to reduce Taxpayer's stand-alone DTA by reason of the TAA payments would violate the deferred tax reserve computational rules of § 1.167(l)-1(h)(2).
2. Putting into effect a rate order reducing the used and useful public utility property includible in rate base in an amount equal to the TAA payments, treating the TAA payments as additional zero-cost capital or eliminating the DTA to reflect the TAA payments while computing book and tax depreciation, tax expense, and the deferred tax reserve with respect to Taxpayer's public utility property for ratemaking purposes would violate the consistency rules of § 168(i)(9)(B)
3. Putting into effect a final rate order that fails to take into account the NOLC DTA as a reduction to the total EDIT available to be amortized, would constitute a violation of the normalization requirements of TCJA section 13001.

4. Implementation of Staff's proposed ratemaking treatments in a final rate order would violate the depreciation normalization rules and thus result in the disallowance of Taxpayer's right to claim accelerated depreciation on all of its State public utility property.

LAW & 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.

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 that definition is essentially unchanged in § 168(i)(10) and the regulations promulgated under former § 167(l) remain valid for application of the normalization rules.

In order to use a normalization method of accounting, § 168(i)(9)(A) of the Code requires that a 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 (hereinafter 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 tax 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.

Rev. Proc. 2020-39 provides guidance concerning the implementation of the EDIT normalization rules of TCJA § 13001 solely with respect to effects of tax rate reductions on timing differences related to accelerated depreciation. Sec. 4.01(6) of Rev. Proc. 2020-39 allows taxpayers that have amortized their EDIT in a manner not in accordance with the Revenue Procedure to prospectively correct the erroneous method at the next available opportunity. Taxpayers so correcting the erroneous method at such time and in such manner will not be treated as having violated the normalization rules of the TCJA.

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. 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. The deferred tax computation rules involve the method and life differences between book and tax depreciation and the statutory tax rate. In regard to request (1), Commission A’s proposal to reduce Taxpayer’s stand-alone DTA by reason of the TAA payments would introduce a variable, that is, the profits of affiliates and/or the TAA payments, other than the method and life differences between book and tax depreciation and the statutory tax rate.

Section 168(i)(9)(B)(ii) provides that the use of a procedure or adjustment that uses an estimate or projection of any of (1) the taxpayer's tax expense, (2) depreciation expense, or (3) reserve for deferred taxes under § 168(i)(9)(A)(ii) does not comply with the Consistency Rule 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.

Therefore, generally, the Normalization Rules do not permit Taxpayer to adjust its rate base by removing used and useful assets) without making similar adjustments to book and tax depreciation expense, tax expense, and the reserve for deferred taxes. Therefore, in regard to request (2), the Normalization Rules do not allow Taxpayer to adjust its rate base in an amount equal to the TAA payments, treat the TAA payments as additional zero-cost capital, or eliminate the DTA to reflect the TAA payments while computing book and tax depreciation, tax expense, and the deferred tax reserve with respect to Taxpayer's public utility property for ratemaking purposes. Doing so would violate the Consistency Rule of § 168(i)(9)(B).

Adjustment of Taxpayer's rate base in an amount equal to the TAA payments or treating the TAA payments as additional zero-cost capital would, in effect, flow through the tax benefits of accelerated depreciation deductions to rate payers. This is so even if the intent of such reduction is not specifically to mitigate the effects of the normalization rules. 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). Accordingly, any adjustment of rate base or treating amounts as zero cost capital that has the effect of offsetting some or all of the level of revenues that would flow through would violate the normalization requirements of § 168(i)(9) of the Code.

Taxpayer and Staff generally agreed that the proper treatment of Taxpayer's EDIT should be determined in the same manner as the resolution of the DTA issue. In regard to request (3), based on the response to requests (1) and (2), Taxpayer's amortization of its EDIT must take into account the $g related to the separate return NOLC DTA as a reduction to the total EDIT available to be amortized.

In the setting of utility rates, a utility's rate base is offset by its EDIT and/or ADIT balance. Taxpayer maintains that the amortization of its EDIT must take into account the $g related to the separate return NOLC DTA as a reduction to the total EDIT available to be amortized. The EDIT should be reduced because these are the amounts that did not actually defer tax due to the presence of the NOLC, as represented in the DTA account. If the EDIT is not reduced, this results in an inappropriate flow-through of tax benefits to ratepayers.

In regard to request (4), Taxpayer sought to correct such treatment prospectively in the current GRC, the "next available opportunity," pursuant to Section 4.01(6) of Rev. Proc. 2020-39. Our understanding is that Commission A is in agreement to follow the outcome of the letter ruling request.

The Normalization Rules were enacted in response to Congressional concerns over the growing number of public utility commissions that were mandating investor-owned regulated utilities to not retain these tax benefits from accelerated depreciation, but, instead, to immediately flow-through all of these tax incentives to ratepayers in the form of lower income tax expense in regulated cost of service rates. Congress' response was to enact legislation that would preclude regulated investor-owned utilities from utilizing accelerated depreciation methods of tax purposes if the related tax benefits were immediately flowed-through to ratepayers in rates or were flowed-through to ratepayers faster than permitted under the Normalization Rules.

The underlying concept and purpose of the Normalization Rules is to prevent the flow-through of these accelerated depreciation-related tax benefits to ratepayers in regulated rates any faster than permitted by the Normalization Rules. Thus, the flow-through of these tax benefits to ratepayers faster than permitted by the Normalization Rules would result in a normalization violation that would preclude the taxpayer from using any of the accelerated tax depreciation methods on public utility property and, instead, require the taxpayer to use the same depreciation method and period as those used to compute depreciation expense in its cost of service for ratemaking purposes. Conversely, a taxpayer that flows through these tax benefits to ratepayers slower than permitted by the Normalization Rules, or that never flows through any of the tax benefits from accelerated depreciation to ratepayers, would not be in violation of those rules.

By reducing Taxpayer’s stand-alone DTA by reason of the TAA payments (or achieving a similar result through other methods), this improperly involves amounts that did not actually defer tax due to the presence of the NOLC, as represented in the DTA account. If the EDIT is not reduced, this results in an inappropriate flow-through of tax benefits to ratepayers

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. However, in the legislative history to the enactment of the normalization requirements of the Investment Tax Credit (ITC), Congress stated that it hopes that sanctions will not have to be imposed and that disallowance of the tax benefit (there, the ITC) should be imposed only after a regulatory body has required or insisted upon such treatment by a utility. See Senate Report No. 92-437, 92nd Cong., 1st Sess. 40-41 (1971), 1972-2 C.B. 559, 581. See also, Rev. Proc. 2017-47, 2017-38 I.R.B. 233, September 18, 2017.

Commission A has, at all times, required that utilities under its jurisdiction use normalization methods of accounting. Taxpayer also intended at all times to comply with the Normalization Rules. Taxpayer has initiated the measures necessary to conform to the Normalization Rules. Taxpayer's failure to comply with the Normalization Rules was inadvertent. Because Commission A, as well as Taxpayer, at all times sought to comply, and because corrective actions will be taken at the earliest available opportunity, it is not appropriate to conclude that the failure to follow the Consistency

Rule or the deferred tax reserve computational rules constituted a normalization violation and apply the sanction of denial of accelerated depreciation to Taxpayer.

We are not providing a ruling on the overall merits of Commission A's policies towards separate return or consolidated return ratemaking. This ruling is solely with respect to the four normalization elements relevant to depreciation-related ratemaking. The treatment of non-ratemaking related payments as part of a TAA does not determine the normalization consequences of those arrangements. Ultimately, since depreciation normalization is based upon the construct of the extension of an interest free loan from the federal government to the utility in the form of deferred taxes, whether and how the group members allocate tax liabilities amongst themselves is irrelevant to the analysis. While under certain circumstances, the intercompany payments under a TAA might create an imputed loan between members, that is not a loan from the federal government, which is the *sine qua non* of depreciation normalization.

RULINGS

We rule as follows in response to Taxpayer's requested rulings:

1. The implementation of Staff's proposal to reduce Taxpayer's stand-alone DTA by reason of the TAA payments would violate the deferred tax reserve computational rules of § 1.167(l)-1(h)(2).
2. Putting into effect a rate order reducing the used and useful public utility property includible in rate base in an amount equal to the TAA payments, treating the TAA payments as additional zero-cost capital or eliminating the DTA to reflect the TAA payments while computing book and tax depreciation, tax expense, and the deferred tax reserve with respect to Taxpayer's public utility property for ratemaking purposes would violate the consistency rules of § 168(i)(9)(B).
3. Putting into effect a final rate order that fails to take into account the NOLC DTA as a reduction to the total EDIT available to be amortized, would constitute a violation of the normalization requirements of TCJA section 13001.
4. Implementation of Staff's proposed ratemaking treatments in a final rate order would violate the depreciation normalization rules and thus result in the disallowance of Taxpayer's right to claim accelerated depreciation on all of its State public utility property. However, as described this disallowance of Taxpayer's right to claim accelerated depreciation would only occur under facts not present in this case.

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.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement 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 representative.

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.

Sincerely,

/S/

Patrick S. Kirwan
Chief, Branch 6
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: Copy for § 6110 purposes

cc: