filed electronically in docket office on 03/12/18

BEFORE THE TENNESSEE PUBLIC UTILITY COMMISSION
NASHVILLE, TENNESSEE

IN RE:

ATMOS ENERGY CORPORATION	**)**	
ANNUAL RECONCILIATION	**)**	**DOCKET NO. 17-00091**
OF ANNUAL REVIEW MECHANISM	**)**	

PRE-HEARING BRIEF OF ATMOS ENERGY CONCERNING TAX NORMALIZATION

Atmos Energy Corporation ("Atmos Energy" or "Company") respectfully submits this legal memorandum addressing the tax normalization problem that would result from using income tax expense from fiscal-year end September 30, 2016, to reconcile the period ending eight months later, on May 31, 2017.

Accelerated depreciation (including bonus depreciation) is intended to subsidize the capital cost of certain depreciable business assets through the tax system. The resulting deductions defer income tax that would otherwise be payable, producing what is, in effect, a zero-cost loan to the owner of the assets. The tax normalization rules ("Normalization Rules") prevent the benefits of accelerated tax depreciation claimed by regulated utilities from being extracted through the rate-setting process by redirecting the benefit towards lowering utility customer rates, thereby converting what was intended to be a business investment subsidy into a consumption subsidy.[1]

---

[1] *See*, Private Letter Ruling ("PLR") 9029040 (July 20, 1990). A PLR represents legal guidance from the National Office of the Internal Revenue Service ("IRS") regarding the application of the tax law to a set of facts furnished by a taxpayer. The advice is binding as between the taxpayer to whom the PLR was issued and the IRS. It is not binding on the IRS as to any other taxpayer. It is not precedential. However, such legal interpretations are significant, particularly because they are authored by the subject matter experts that are employed by the agency charged with the responsibility for enforcing the provisions that are the subject of the interpretations. Thus, tax

Public utilities are entitled to claim accelerated methods of depreciation with respect to public utility property only if they utilize a "normalization method of accounting." Code §168(f)(2). (Where such a method is not used, a utility may only claim regulatory depreciation for tax purposes.) Code §168(i)(9)(A) and Treas. Reg. §1.167(l)-1(h)(1)(i)(b) require the utility (1) to compute its tax expense for ratemaking purposes using ordinary non-accelerated depreciation (*i.e.*, its tax expense for ratemaking must include both current and deferred tax expense), and (2) to make adjustments to a reserve to reflect the deferral of taxes resulting from the additional depreciation (*i.e.*, it must credit an ADIT account, which will be subtracted from rate base). In this manner, the Normalization Rules provide for the mandatory recognition of deferred taxes and preclude direct flow-through of the benefit to customers. They do, however, permit utilities to provide customers the "zero-cost" benefit produced by claiming accelerated depreciation.

Recognizing that some of the benefit of accelerated tax depreciation can be extracted inappropriately by manipulating the amount of ADIT treated as zero-cost capital, Treas. Reg. §1.167(l)-1(h)(6)(i) limits the ADIT balance by which rate base may be reduced (or which may be otherwise treated as zero-cost capital). Specifically, it states

> . . . 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 tax expense*** in computing cost of service in such ratemaking.

---

practitioners routinely read PLRs and use them in the development of the advice they provide to clients. This is particularly true in the area of the Normalization Rules where there are virtually no judicial decisions and very few broad-based government pronouncements.

26 C.F.R. § 1.167(l)-1(h)(6)(i) (emphasis added). In other words, the Normalization Rules do not permit rate base to be reduced by an amount of deferred taxes in excess of the amount that has been reflected (or is projected to be reflected) in cost of service during the period (hereafter, the "Limitation").

In the 1970s, the operation of the Limitation was tested by the California Public Utilities Commission ("CPUC") and the California courts, which favored flow-through tax accounting for accelerated depreciation. Subsequent to the enactment of the Normalization Rules as part of the Tax Reform Act of 1969, several of the larger California utilities elected to claim accelerated depreciation, which was only available so long as they normalized the benefit thereof. The CPUC attempted to devise a methodology that, while meeting the literal terms of the Normalization Rules, mitigated the economic impact to customers of utilities' compliance with those rules. It developed something referred to as the "Average Annual Adjustment" ("AAA") method, which, among other features, involved projecting the ADIT balance out well beyond the period of time for which other elements of rate base, tax expense, and depreciation expense were projected. Because ADIT balances were generally increasing during the projected period, the farther out ADIT balances were projected, the greater the amount of ADIT used to offset rate base in the ratemaking process. Two utilities subject to AAA method ratemaking applied for and received PLRs.[2] In each of the two PLRs, the Service stated:

> The Commission established rates with respect to each of the three test years using actual deferred tax reserve figures for the years 1973, 1974 and 1975 to determine the amount of the exclusion from the rate base under its average annual adjustment method while all related factors were frozen at the estimated levels. We believe that the use of the actual deferred tax reserve in conjunction with the estimated tax expense is inconsistent with sections 1.167(l)-1(h)(1)(i) and 1.167(l)-1(h)(2)(i) of the regulations. Under these sections of the regulations the reserve for deferred taxes that is deducted from

[2] PLR 7836038 (June 8, 1978) and PLR 7836048 (June 9, 1978).

> the adjusted rate base has to be the same deferred portion of the tax expense as described in these sections of the regulations. If such consistency is absent, the exclusion of the actual reserve will be prohibited by section 1.167(l)-1(h)(6)(i).
>
> . . .
>
> ***A larger reserve deducted from the rate base without consistency in computing tax expense would not be considered to be a proper normalization method of accounting and would be in excess of the amount as permitted by the regulations.***

Id. (emphasis added). In these two PLRs, the Service concluded that Treas. Reg. §1.167(l)-1(h)(6)(i), the Limitation, had embedded within it a requirement that there be consistency between a utility's ADIT balance for purposes of determining both rate base and tax expense.[3]

Notwithstanding these PLRs, the CPUC and the California state courts continued to employ the AAA method. Before the Service actually imposed the sanctions associated with violating the Normalization Rules, federal legislation was enacted that "defused" the situation by adding a clarifying statutory provision (26 U.S.C. §168(i)(9)(B)) (hereafter, the "Consistency Rule") to the Normalization Rules, explicitly prohibiting regulatory procedures such as the AAA.[4] The Consistency Rule specifically precludes the "mixing and matching" of regulatory conventions and measurement periods where that practice impacts the benefits of accelerated depreciation. Code §168(i)(9)(B) provides:

> (i) In general. One way in which the requirements of subparagraph (A) are not met is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with the requirements of subparagraph (A).
> (ii) Use of inconsistent estimates and projections. The procedures and adjustments which are to be treated as inconsistent for purposes of clause (i) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under subparagraph (A)(ii) unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.

---

[3] Note that the statutory Consistency Rule of Code §168(i)(9)(B) (discussed below) was enacted later.

[4] Section 541 of the Highway Revenue Act of 1982 [P.L. 97-424].

26 U.S.C. § 168(i)(9)(B).

Numerous situations have been found to violate the Consistency Rule. *See, e.g.,* PLR 200651026 (Dec. 22, 2006)(attached) (use of a five-year average for determining certain components of rate base but an end-of-test-year amount for ADIT violates the normalization consistency requirement of § 168(i)(9)(B)); PLR 200418001 (Apr. 30, 2004) (attached) (where taxpayer's rate base, tax expense, and depreciation expense would be determined without the cost of certain excluded property, if the ADIT associated with the excluded property were not likewise removed, the consistency requirement of section 168(i)(9)(B) would be violated); PLR 9552007 (Dec. 29, 1995) (attached) (under intervenor's proposal, the tax expense component of the cost of service would be reduced for the depreciation allowance attributable to a disallowed portion of taxpayer's plant; as a result, for ratemaking purposes 100 percent of taxpayer's basis in the plant would be used in determining taxpayer's qualified investment for the depreciation allowance but less than 100 percent of taxpayer's basis in the plant would be used for determining regulated depreciation expense and for determining rate base; thus, intervenor's treatment of the tax expense component of the cost of service would violate the consistency requirement, resulting in a normalization violation).

There is no requirement that a taxpayer (or a regulator) intend to flow through all or part of the benefit of accelerated depreciation for a procedure to violate the Normalization Rules. Any procedure that achieves that economic effect will give rise to a violation.

"Mixing" tax expense from the period ending September 30, 2016, with ADIT and rate base from the period ending May 31, 2017, contravenes the Limitation and Consistency Rules in at least three ways. First, ADIT used to reduce rate base cannot exceed the amount of ADIT for the period used in determining tax expense. The Consumer Advocate's position would measure

the ADIT by which rate base is reduced as of May 31, 2017, while tax expense is measured during the period October 1, 2015 through September 30, 2016. Thus, at least some of the ADIT balance as of May 31, 2017, will not have been reflected in tax expense as measured for the Company's 2016 fiscal year. Second, the ADIT balance as of May 31, 2017 will contain deferred taxes created by plant that was not even owned by the Company during its 2016 fiscal year but was acquired between October 1, 2016 and May 31, 2017. Third, even in the case of assets that were owned by Atmos Energy during that earlier period, the May 31, 2017 ADIT balance will include deferred taxes produced by book and tax depreciation that occurred after the end of the Company's 2016 fiscal year.

In contravention of the Consistency Rule, the Consumer Advocate's position improperly "mixes" tax expense and ADIT from different time periods. And contrary to the Limitation, the Consumer Advocate's position uses an ADIT balance (from May 31, 2017) that is higher than the ADIT balance from the period used to determine tax expense (September 30, 2016). *See* Exhibit GKW-R-1, WP 7-1; Atmos Energy Resp. to CPAD DR 1-10, Att. 3, Plant Balances 2017 TN True-Up Filing.xlsx (filed October 19, 2017). If adopted by the TPUC, these Normalization Rule violations would disqualify Atmos Energy from claiming accelerated depreciation in the future, allowing only regulatory depreciation for tax purposes. *See, e.g.*, PLR 200824001 (June 13, 2008). If that were to occur, the Company would, in the future, create no more depreciation-related deferred taxes to replace the "run down" of the existing ADIT balance as the underlying timing differences reverse. This inability to generate additional cost-free capital in conjunction with the depletion of the Company's existing stock of cost-free capital would have a serious and long-term detrimental impact on ratepayers.

As the Consumer Advocate has noted, in its first and only ARM reconciliation filing, Docket 16-00105, Atmos Energy did, in fact, employ the same methodology it now asserts would give rise to a violation of the Normalization Rules. The use of that methodology, while unfortunate, was inadvertent insofar as no one at the Company or involved in the proceeding was aware that there might be Normalization-Rule implications. "Congress intended that the harsh sanctions of disallowance of a public utility's use of accelerated depreciation and recapture of the tax benefits of the past use of such accelerated depreciation to be imposed only, it at all, after a regulatory body has required or insisted upon such treatment by a utility." PLR 200824001 (June 13, 2008). Consistent with that goal, the IRS recently established a procedure allowing for the correction of "inadvertent" normalization violations. *See* Revenue Procedure 2017-47, Accelerated Cost Recovery System-Public Utility Property-Safe-Harbor for Inadvertent Normalization Violations. A copy is attached for convenient reference and was Attachment 1 to Atmos Energy's Response to DR 1-16. This Revenue Procedure provides that, under certain circumstances, inadvertent violations of the Normalization Rules will be forgiven. To merit this dispensation, after recognizing the violation, a utility must rectify the violative regulatory procedure at the next available opportunity (as defined). That is precisely what Atmos Energy is attempting to do in this proceeding. If it succeeds, then its erroneous treatment in Docket 16-00105 will not give rise to a normalization violation. If it does not succeed, then it will not be entitled to dispensation under the Revenue Procedure because, having recognized the problem, it did not change the erroneous method in this proceeding – the next available opportunity. By contrast, adopting the Company's proposal would cure the defect and entitle the Company to the relief provided for in the Revenue Procedure.

CONCLUSION

The Normalization Rules require consistency in the determination of tax expense, ADIT, rate base, and depreciation, and prohibit the use of an ADIT figure greater than the amount of ADIT during the period from which tax expense is derived. "Mixing" tax expense from September 30 with ADIT from May 31 violates both of these requirements. And that is what the Consumer Advocate's position would require.

Respectfully submitted,

NEAL & HARWELL, PLC

By: _____

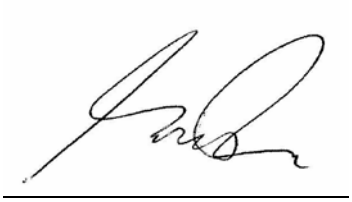
A. Scott Ross, #15634
1201 Demonbreun Street, Ste. 1000
Nashville, TN 37203
(615) 244-1713 – Telephone
(615) 726-0573 – Facsimile
sross@nealharwell.com

Counsel for Atmos Energy Corporation

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing has been served, via the method(s) indicated below, on the following counsel of record, this the 12th day of March, 2018.

( ) Hand	Wayne M. Irvin
( ) Mail	Assistant Attorney General
( ) Fax	Office of the Attorney General
( ) Fed. Ex.	Consumer Protection and Advocate Division
(X) E-Mail	P. O. Box 20207
	Nashville, TN 37202-0207
	Wayne.irvin@ag.tn.gov



PLR 200651026 (IRS PLR), 2006 WL 3760091

Internal Revenue Service (I.R.S.)

IRS PLR
Private Letter Ruling

Issue: December 22, 2006
September 5, 2006

Section 167 -- Depreciation
167.00-00 Depreciation
167.22-00 Public Utility Property
167.22-01 Normalization Rules

CC:PSI:B06

PLR-152844-05

LEGEND:

Taxpayer =

State =

Commission =

Date =

Effective Date =

X =

Director =

Dear *** :
This letter responds to the request, dated October 11, 2005, of Taxpayer for a ruling on whether it is proper to determine the Taxpayer's revenue requirement using a multi-year average for the historical investment component of rate base but not using a multi-year average for the deferred tax reserve component.

The representations set out in your letter follow.

Taxpayer is an integrated electric and natural gas utility headquartered in State. Taxpayer's business includes regulated utility operations and unregulated energy activities. Its regulated utility operations are subject to the regulatory jurisdiction of Commission with regard to its retail rates and certain conditions of service.

On Date, Taxpayer filed an application for changes to its service rates with Commission. That request used the fiscal year X as its test year and calculated the “general common plant” component of the rate base using the year-end rate base balances of the assets comprising general common plant. Taxpayer's proposal reduced this balance to that portion allocable to the State jurisdictional amount. Taxpayer further reduced this amount by the related allocated accumulated

 © 2018 Thomson Reuters. No claim to original U.S. Government Works.

depreciation and amortization as well as the related allocated accumulated deferred income tax (ADIT) reserve. These reductions were made using the allocated year-end balances as of the close of X of the depreciation, amortization, and income tax.

Commission staff has proposed that Taxpayer adjust rate base in respect of general common plant so that a historical five-year average is used to determine most of the components of general common plant rather than the end-of-test-year balances. However, while the commission staff recommended that the assets comprising general common plant as well as the depreciation and amortization percentages related to those assets be determined using a five-year average, it did not recommend adjustment of the Taxpayer's proposal to use the end-of-test year balance of accumulated depreciation or deferred tax reserves. Commission adopted the staff's recommendation and Taxpayer requested that the Commission reconsider, arguing that use of a five-year average for general common plant and an end-of-test-year balance for ADIT caused a normalization violation. Commission and Taxpayer then prepared this request together. However, Commission also approved, as of Effective Date, a revised tariff using five-year averages for assets comprising general common plant and an end-of-test-year balance for deferred tax reserve and accumulated depreciation component of rate base. Because of the ruling request, the revised tariff was not finalized by Commission.

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(1)-1(h)(1)(i) of the regulations 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.

 © 2018 Thomson Reuters. No claim to original U.S. Government Works.

Section 1.167(1)-1(h)(1)(iii) of the regulations 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.

Section 1.167(1)-1(h)(2)(i) of the 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 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).

Under § 1.167(1)-1(h)(6)(i), the reserve excluded from the rate base must be determined by reference to the same historical period as used in determining ratemaking tax expense. A taxpayer may use historical or projected data in calculating these two amounts, but they must be done consistently.

Section 203(e) of the Act provides another way in which a normalization method of accounting is not being used for public utility property.

According to section 203(e)(1) of the Act, a normalization method of accounting shall not be treated as being used with respect to any public utility property for purposes of section 167 or 168 of the Code 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 that this reserve would be reduced under the average rate assumption method (ARAM).

The term "excess tax reserve" is defined in section 203(e)(2)(A) of the Act as the excess of:

(i) the reserve for deferred taxes as described in former section 167 (1)(3)(G)(ii) or 168(e)(3)(B) (ii) of the Code as in effect on the day before the date of the enactment of the Act, over;

(ii) the amount that would be the balance in this reserve if the amount of the reserve were determined by assuming that the corporate rate reductions provided in the Act were in effect for all prior periods.

Section 203(e)(2)(B) of the Act defines the ARAM and explains the calculations under this method. ARAM is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its books of account that gave rise to the reserve for deferred taxes. Under the ARAM, if timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying:

(i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by;

(ii) the amount of the timing differences that reverse during this period.

Rev. Proc. 88-12, 1988-1 C.B. 637, provides further guidance as to the application of the ARAM to the excess tax reserve. Section 2.04 of Rev. Proc. 88-12 provides that under the ARAM, excess tax reserves pertaining to a particular vintage or vintage account are not flowed through to ratepayers until such time as the timing differences in the particular vintage account reverse. Moreover, it is a violation of section 203(e) of the Act for taxpayers to adopt any accounting treatment

 © 2018 Thomson Reuters. No claim to original U.S. Government Works.

that, directly or indirectly, circumvents the rule set forth in the previous sentence. Section 2.04 also provides that section 203(e) of the Act does not modify the normalization requirements of former section 167(l) or section 168(i) of the Code.

Sections 3 and 4.01 of Rev. Proc. 88-12 provide that a taxpayer who lacks sufficient vintage account data necessary to apply the ARAM, can use the "Reverse South Georgia Method." In general, a taxpayer uses that method if it (a) computes the excess tax reserve 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 (b) reduces the excess tax reserve ratably over the remaining regulatory life of the property.

For a public utility to use accelerated depreciation in determining its federal income tax liability, section 203(e) of the Act requires that normalization accounting be used to reduce the excess tax reserve in calculating the rates to be charged the utility's customers and in maintaining the regulated books of account. Under section 203(e) of the Act, the immediate flow through of the excess tax reserve to the utility's customers is prohibited. Instead, the excess tax reserve is to be reduced and flowed through to cost of service no more rapidly that this reserve would be reduced under the ARAM, or, where appropriate, the Reverse South Georgia Method.

Section 203 (e) of the Act limits the rate at which the excess tax reserve may be reduced and flowed through to the utility's customers in setting rates. It does not require the utility to flow through the excess tax reserve to its customers, but permits the utility to do so provided the reduction to cost of service is not more rapidly than would be under the ARAM. Thus, section 203 (e) of the Act imposes a limitation on when the excess tax reserve may be returned to the utility's customers in the form of reduced rates.

For purposes of properly accounting for any deferred taxes, § 168(i)(9)(B)(ii) provides that ratemaking estimates or projections of tax expense, depreciation expense, and the reserve for deferred taxes must be consistent with each other and with the estimate or projection of rate base. Thus, the use of a five-year average for determining certain components of rate base and not using that average for the deferred tax reserve component, but rather using an end-of-test-year amount for the deferred tax reserve component, as proposed by Commission, violates the normalization consistency requirement of § 168(i)(9)(B). The Commission has approved, as of Effective Date a tariff, pending the outcome of this ruling request, that is inconsistent with the conclusions reached herein. In our view, finalizing the tariff by issuing a new rate order correcting the calculations in accord with the foregoing prospectively only, without providing for rate relief from Effective Date, would trigger a normalization violation back to Effective Date and the violation would continue until the new rate order was issued consistent with the requirements of § 168(i) of the Code. The new rate order must be consistent with the requirements of § 168(i) in order to comply with the provisions of § 168 and for Taxpayer to remain eligible to use a normalization method of accounting.

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 Technican Reviewer, Branch 6 (Passthroughs & Special Industries)

Section 6110(j)(3) of the Internal Revenue CodeThis document may not be used or cited as precedent. .

PLR 200651026 (IRS PLR), 2006 WL 3760091

End of Document © 2018 Thomson Reuters. No claim to original U.S. Government Works.

PLR 200418001 (IRS PLR), 2004 WL 933116

Internal Revenue Service (I.R.S.)

IRS PLR
Private Letter Ruling

Issue: April 30, 2004
January 13, 2004

Section 167 -- Depreciation
167.00-00 Depreciation
167.22-00 Public Utility Property
167.22-01 Normalization Rules
Section 168 -- (Repealed-1976 Act) Amortization of Emergency Facilities
168.00-00 Modified Accelerated Cost Recovery System
168.24-00 Public Utility Property
168.24-01 Normalization Rules

CC: PSI: B06 - PLR-101933-03
In Re:

Private Letter Ruling Request on Normalization

Taxpayer =

Commission =

Department =

State X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

$B =

$C =

Dear *** :
This letter is in response to your letter dated December 2, 2002, requesting a ruling under the normalization requirements of former section 167(l) and section 168(i)(9) of the Internal Revenue Code with respect to the accumulated deferred

 © 2018 Thomson Reuters. No claim to original U.S. Government Works.

federal income tax ("ADFIT") reserve attributable to property that is removed from Taxpayer's regulated books of account.

Taxpayer represents that the facts are as follows:

Taxpayer is the parent company of an affiliated group of corporations that files a consolidated federal income tax return on a calendar year basis using the accrual method of accounting. Taxpayer is a regulated public utility engaged in, among other things, the generation, transmission, distribution, and sale of electrical energy.

In State X, Taxpayer provides electric distribution and transmission services and is regulated by the Commission. Taxpayer's rates in State X are established and approved by the Commission on a "rate of return" basis.

On Date 1, the Commission ordered audits of both the electric transmission and electric distribution plant accounts of Taxpayer in State X. The purposes of the audit were (1) to support and establish proper depreciation rates for future ratemaking, and (2) to identify and remove from regulated plant accounts any assets not in service, not properly identified, not verifiable, or not properly includible as transmission and distribution assets.

The final audit reports (one for transmission plant and one for distribution plant) issued on Date 2 and Date 3, respectively, recommended adjustments in Taxpayer's regulated plant accounts based on the physical inventory and independent valuation conducted by the auditors. The adjustments to these plant account balances resulted from Taxpayer not properly maintaining its plant accounts. Following the issuance of the audit report, Taxpayer and the Department, among others, entered into a settlement agreement.

Pursuant to the settlement which is pending before the Commission, property in the amount of $B ("Excluded Property") will be removed from Taxpayer's regulated books of account. However, the accumulated depreciation associated with the Excluded Property will not be removed from Taxpayer's regulated books of account.

In Date 4, Taxpayer initiated a rate case in State X with respect to its State X electric division. In its initial rate case filing, Taxpayer excluded from its computation of regulated rate base the Excluded Property in accordance with the settlement referred to above. As noted above, the accumulated depreciation reserve in rate base was not adjusted for the accumulated depreciation reserve on the Excluded Property. Taxpayer did not reflect regulatory depreciation associated with the Excluded Property in either its regulated depreciation expense or in its computation of regulated tax expense. Additionally, Taxpayer removed the ADFIT reserve associated with the Excluded Property (in the amount of $C) from its computation of regulated rate base.

The Department took the opposite position on the ADFIT reserve associated with the Excluded Property and sought to have this ADFIT reserve maintained on Taxpayer's regulated books of account to serve as a reduction to rate base. However, in its final order dated Date 5, the Commission adopted Taxpayer's position and agreed to the removal of the ADFIT reserve associated with the Excluded Property, but ordered Taxpayer to submit a letter ruling request to the Internal Revenue Service for the purpose of determining whether adoption of the Department's proposed treatment of the ADFIT reserve associated with the Excluded Property violates the normalization requirements.

Ruling Requested

Accordingly, Taxpayer seeks the following ruling:

Would the maintenance of the ADFIT reserve associated with the Excluded Property on Taxpayer's regulated books of account and its reflection in the computation of regulated rate base constitute a violation of the normalization rules under

 © 2018 Thomson Reuters. No claim to original U.S. Government Works.

former section 167(l) and section 168(i)(9) of the Code, and section 1.167(l)-1(b) and 1.167(a)-11(b)(6) of the Income Tax Regulations?

Law and Analysis

Section 168(i)(10) of the Code provides, in part, that the term "public utility property" means 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 of political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

Prior to the Revenue Reconciliation Act of 1990, the definition of public utility property was contained in section 167(l)(3)(A) of the Code and section 168(i)(10) which defined public utility property by means of a cross reference to section 167(l)(3)(A). The definition of public utility property is unchanged. Section 1.167(l)-1(b)(1) of the regulations provides that under section 167(l)(3)(A), property is public utility property during any period in which it is used predominantly in a section 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 have been established or approved by a regulatory body described in section 167(l)(3)(A). The term "regulatory body described in section 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 that 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.

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 purposes of 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 no shorter than, the method and period used to compute its depreciation for such purposes. Under section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 with respect to public utility property 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 in which the requirements of section 168(i)(9)(A) are not met is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment that is inconsistent with the requirements of section 168(i)(9)(A). Section 168(i)(9)(B)(ii) provides that the procedures and adjustments that are to be treated as inconsistent for purposes of section 168(i)(9)(B)(i) shall include any procedure or adjustment for ratemaking purposes that uses 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 the other two such items and with respect to the rate base.

Former section 167(l) of the Code generally provides that public utilities are entitled to use accelerated methods of depreciation if they use a "normalization method of accounting." A normalization method of accounting is defined in

 © 2018 Thomson Reuters. No claim to original U.S. Government Works.

former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). According to former section 167(l)(3)(G), the consistency requirements of section 168(i)(9)(B) apply to former section 167(l).

Section 1.167(l)-1(h)(1)(i) of the regulations 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) of the regulations 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.

Section 1.167(l)-1(h)(2)(i) of the 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 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(a)-11(b)(6) of the regulations provides similar rules for public utility property subject to depreciation under the Class Life Asset Depreciation Range System (CLADR).

In the present situation, Taxpayer's rate base, tax expense, and depreciation expense for ratemaking purposes will be determined without the cost of the Excluded Property. If the ADFIT reserve associated with the Excluded Property is not removed from Taxpayer's regulated books of account and is used to reduce Taxpayer's rate base, the consistency requirement of section 168(i)(9)(B) will be violated because Taxpayer will not include the cost of the Excluded Property in its rate base or include the amount of related depreciation in its computation of tax expense and depreciation expense for ratemaking purposes.

Ruling

Based solely on Taxpayer's representations and the law and analysis as set forth above, we conclude that the maintenance of the ADFIT reserve associated with the Excluded Property on Taxpayer's regulated books of account and its reflection in the computation of regulated rate base would constitute a violation of the normalization rules under former section 167(l) and section 168(i)(9) of the Code, and sections 1.167(l)-1(b) and 1.167(a)-11(b)(6) of the regulations.

Except as specifically set forth above, no opinion is expressed concerning the federal income tax consequences of the above-described facts under any other provision of the Code or regulations. This letter ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

In accordance with the power of attorney on file, a copy of this letter is being sent to Taxpayer's authorized legal representative.
Sincerely yours,

Kathleen Reed
Senior Technician Reviewer
Office of the Associate Chief Counsel (Passthroughs and Special Industries)

Enclosures (2):

 © 2018 Thomson Reuters. No claim to original U.S. Government Works.

Copy of this letter

Copy for section 6110 purposes

Section 6110(j)(3) of the Internal Revenue CodeThis document may not be used or cited as precedent. .

PLR 200418001 (IRS PLR), 2004 WL 933116

End of Document © 2018 Thomson Reuters. No claim to original U.S. Government Works.

PLR 9552007 (IRS PLR), 1995 WL 764845

Internal Revenue Service (I.R.S.)
Private Letter Ruling

Issue: December 29, 1995
September 22, 1995

Section 167 -- Depreciation
167.00-00 Depreciation
167.09-00 Year of Purchase
Section 168 -- (Repealed-1976 Act) Amortization of Emergency Facilities
168.00-00 (Repealed-1976 Act) Amortization of Emergency Facilities
168.09-00 Public Utility Property

CC:DOM:P&SI:6 / TR-31-1953-94
Re: Letter Ruling Request

Legend:

Taxpayer

Parent

Intervenor

Commission

State X

Docket A

Plant (Units I & II)

Dear ***
This is in response to your letter ruling request, dated July 22, 1994, regarding the above-captioned Taxpayer. At the request of the Commission, the Taxpayer has asked us to rule whether the provisions of section 168(i)(9)(A) of the Internal Revenue Code are violated if a tax deduction for depreciation (straight-line over book life) is included in the calculation of regulated federal income tax expense when the depreciation relates to costs not included in rate base or cost of service.

The Taxpayer has represented the following facts:

The Taxpayer is a wholly owned subsidiary of Parent. The Taxpayer is an investor-owned regulated public utility engaged in the generation, purchase, transmission, distribution, and sale of electric energy in State X.

During the pendency of Docket A, a final resolution addressing the prudence of construction costs of Plant Units I and II was obtained. As a result, certain portions of the Plant Unit II were to be denied inclusion in rate base. The Commission approved the resolution.

 © 2018 Thomson Reuters. No claim to original U.S. Government Works.

Regarding the Docket A proceeding, the Taxpayer's rate filing reflected costs associated with the commercial operation of Plant Unit II. The Taxpayer requested that certain costs of Plant Unit I not previously subject of a rate hearing be included in rate base. Further, the taxpayer asked that certain previously disallowed costs of Plant Unit I be included in rate base. Finally, the Taxpayer requested that certain costs of Plant Unit II be included in rate base.

The Commission in Docket A disallowed certain costs as imprudent. Certain intervenors, including Intervenor, proposed that in determining regulated federal income tax expense, a depreciation deduction relating to the disallowed costs be included. The depreciation deduction would equal the tax basis of the disallowances divided by the Plant book life.

Based on State X law, the Commission must exclude a utility's imprudently incurred costs and the depreciation associated with those costs from rates charged to customers. Consequently, no depreciation expense was provided by the Commission in cost of service for the disallowed costs not included in rate base. No accumulated deferred federal income tax was included in rate base for the costs that had been disallowed and not included in rate base.

The Plant has been placed in service and is subject to section 168 of the Code. The entire plant is used to generate electricity for the Taxpayer's customers; the entire output is sold at rates set by the Commission. The Commission has allowed the Taxpayer to recover all of the reasonable and necessary operation costs of the Plant.

The Taxpayer, at the request of the Commission, is asking the Internal Revenue Service to rule whether the reflection of depreciation related to the Plant's disallowed costs in the (regulated) federal income tax calculation would violate the normalization requirements of the Code. The Taxpayer takes the position that since the disallowed costs were excluded from rate base and from cost of service (depreciation expense), the federal depreciation deductions can not be used in the federal income tax component of cost of service.

For the reasons set out below, we conclude that reflection of depreciation, relating to the disallowed costs, in the federal tax expense would violate the normalization rules of section 168(i)(9).

Section 168(i)(10) of the Code 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 section 167(l)(3)(A) of the Code and section 168(i)(10) which defined public utility property by means of a cross reference to section 167(l)(3)(A). The definition of public utility property is unchanged. Section 1.167(l)-1(b) of the regulations provides that under section 167(l)(3)(A), property is public utility property during any period in which it is used predominantly in a section 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 section 167(l)(3)(A). The term "regulatory body described in section 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 section 168(i)(10) and former section 46(f)(5) of the Code are essentially identical. Section 1.167(l)-1(b) of the regulations 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) of the regulations 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

 © 2018 Thomson Reuters. No claim to original U.S. Government Works.

of rates with the regulatory body which has the power to approve such rates even though the body has taken no action on the filed schedule or generally leaves undisturbed rates filed.

The regulations under former section 46 of the Code, specifically section 1.46-3(g)(2), contain merely an expanded definition of regulated rates. This 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 section 167 of the Code. Nevertheless, there is an expressed reference to rate of return in section 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 section 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. These are explicit elements of the definition of rate of return regulation contained in section 1.46-3(g)(2) of the regulations. Thus, it is clear that the definition of public utility property is the same for purposes of the investment tax credit and depreciation. It follows, that if property is public utility property for purposes of the credit it is also public utility property for purposes of depreciation.

Sections 168(f)(2), (i)(9) and (i)(10) of the Code provide that before an owner of public utility property can depreciate that property using an accelerated method of depreciation, the normalization requirements must be met. Section 168(i)(9)(A) states that in order to use a normalization method of accounting with respect to any public utility property for purpose of subsection (f)(2) the taxpayer must, 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, use a method of depreciation with respect to such property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for such purposes; and if the amount allowable as a deduction with respect to such property differs from the amount that would be allowable as a deduction under section 167 using the method (including the period, first and last year convention, and salvage value) used to compute regulated tax expense, 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 a normalization method of accounting does not exist if for ratemaking purposes a procedure or adjustment is used which is inconsistent with the requirements of section 168(i)(9)(A). Section 168(i)(9)(B)(ii) provides that the procedures and adjustments which are to be treated as inconsistent for purposes of section 168(i)(9)(B)(i) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes unless such estimate or projection is also used, for ratemaking purposes, with respect to the other two such items and with respect to rate base.

Under the Intervenor's proposal, the tax expense component of the cost of service would be reduced for the depreciation allowance attributable to the disallowed portion of the Plant. As a result, for ratemaking purposes 100 percent of Taxpayer's basis in the Plant would be used in determining Taxpayer's qualified investment for the depreciation allowance while less than 100 percent of Taxpayer's basis in the Plant would be used for determining regulated depreciation expense and for determining rate base. Thus, the treatment of the tax expense component of the cost of service would violate the consistency requirements.

Consequently, based on Taxpayer's representations and the analysis as set forth above, we conclude, as follows:
1. All of the Plant (Units I and II), including the disallowed costs, is public utility property within the meaning of section 168(i)(10) of the Code and, thus, is subject to the normalization provisions of section 168(i).

2. In order to satisfy the requirements of section 168(i)(9)(B) of the Code there must be consistency in the treatment of costs for rate base, regulated depreciation expense, tax expense, and deferred tax revenue purposes. Consequently, those consistency rules would be violated if, as the Intervenor proposes, the federal income tax component of cost of

 © 2018 Thomson Reuters. No claim to original U.S. Government Works.

service reflects depreciation of the Plant's disallowed costs but those costs are not included in rate base or the depreciation component of cost of service.

Except as specifically set forth above, no opinion is expressed concerning the federal income tax consequences of the above-described facts under any other provision of the Code or regulations. This letter ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that this ruling may not be used or cited as precedent.

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

CHARLES B. RAMSEY
Chief, Branch 6
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Section 6110(j)(3) of the Internal Revenue CodeThis document may not be used or cited as precedent. .
PLR 9552007 (IRS PLR), 1995 WL 764845

End of Document © 2018 Thomson Reuters. No claim to original U.S. Government Works.

Safe Harbor for Inadvertent Normalization Violations

Rev. Proc. 2017-47

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor concerning inadvertent or unintentional uses of a practice or procedure that is inconsistent with §§ 50(d)(2) and 168(i)(9) of the Internal Revenue Code of 1986, as amended (Code), which require the use of the Normalization Rules (as defined in section 4.04 of this revenue procedure). If the safe harbor under section 5 of this revenue procedure applies, the Internal Revenue Service (Service) will not assert that a taxpayer's inadvertent or unintentional use of a practice or procedure that is inconsistent with §§ 50(d)(2) and 168(i)(9) of the Code constitutes a violation of the Normalization Rules. This revenue procedure does not limit or change the process by which a taxpayer may request a letter ruling or a referral for a technical advice memorandum that the taxpayer's proposed practice or procedure is consistent or inconsistent with the Normalization Rules.

SECTION 2. BACKGROUND

In general, normalization is a system of accounting used by regulated public utilities to reconcile the tax treatment of the Investment Tax Credit (ITC) or accelerated depreciation of public utility assets with their regulatory treatment. Under normalization, a utility receives the tax benefit of the ITC or accelerated depreciation in the early years

of an asset's regulatory useful life and passes that benefit on to ratepayers ratably over the regulatory useful life in the form of reduced rates. The remainder of this section 2 describes the intent of Congress in adopting the Normalization Rules and their operation under the Code and Income Tax Regulations.

.01 Congressional Intent. Congress had two principal objectives in adopting the Normalization Rules. The first objective was to preserve the utility's incentive to invest. Congress enacted the ITC and accelerated depreciation to stimulate investment. These incentives were not intended to subsidize the consumption of any products or services, including utility products or services. Recognizing that public utility rates are set based on the utility's costs incurred to provide the utility service, including federal income tax expense, Congress enacted a set of rules to assure that some or all of the value of the incentives it provided for utility capital investment would not be diverted from investment by utilities to lower prices for consumption by customers of utilities.

The second objective was to protect the government's tax revenue. Congress reasoned that when a utility elected accelerated depreciation and its regulator lowered rates to reflect the resulting tax benefit, the federal government would experience a reduction in tax revenue twice: once from the added accelerated depreciation deductions taken by the utility, and again from the decline in the revenue received by the utility as a result of its lower rates. See S. Rep. No. 91-552, at 17 (1969). The same impact results if a utility is permitted to flow through the benefit of its ITC to customers.

.02 Depreciation. Section 168 of the Code provides taxpayers generally with the

benefits of the accelerated cost recovery system in the computation of their depreciation deduction for federal income tax purposes. Section 168(f) provides the description of certain property for which the benefits of § 168 do not apply. Section 168(f)(2) provides that § 168 does not apply to any public utility property, as defined in § 168(i)(10), if the taxpayer does not use a normalization method of accounting. In general, § 168(i)(10) defines "public utility property" as property used predominantly in the trade or business of furnishing or selling (A) electrical energy, water, or sewage disposal services, (B) gas or steam through a local distribution system, (C) certain communications services, or (D) the transportation of gas or steam by pipeline, if rates for such furnishing or sale are established or approved by 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.

Section 168(i)(9) describes what constitutes a "normalization method of accounting." The rules provided in § 168(i)(9) recognize that the rates a regulated public utility is permitted to charge its customers are established or approved by regulators based on the utility's cost of service taking into account the depreciation of assets and federal income tax expense. The Normalization Rules under § 168(i)(9)(A)(i) require the taxpayer to compute the federal income tax expense taken into account in setting its rates using a depreciation method that is the same as, and a depreciation period that is no shorter than, the method and period used to compute the depreciation expense for purposes of computing rates. Under § 168(i)(9)(A)(ii), a taxpayer must account for any

difference between its federal income tax expense taken into account in computing its rates and the actual federal income tax it pays as a reserve for deferred taxes. If the taxpayer uses estimates or projections in determining for rate-making purposes its tax expense, depreciation expense, or reserve for deferred taxes, the Normalization Rules under § 168(i)(9)(B) require the use of consistent estimates or projections with respect to the other two items and rate base.

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 § 167 of the Code 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.

.03 Investment Tax Credit. Section 46 of the Code sets forth certain investment credits against income tax. Section 50(d) provides special rules for certain taxpayers to qualify for those credits, including § 50(d)(2), which provides that rules similar to the limitations provided under former § 46(f) applicable to public utility property prior to the enactment of the Revenue Reconciliation Act of 1990, Pub. L. No. 101-508, Title XI, 104 Stat. 1388, shall apply to certain regulated companies. The Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, repealed the ITC generally with respect to public utility property placed in service after 1985; however, due to the long useful life of much public utility property, these provisions retain their vitality.

Under the general rule of former § 46(f), those regulated companies are not entitled to the ITC if either the taxpayer's cost of service or rate base for ratemaking purposes is reduced by any portion of the credit. However, the statute provides important exceptions. Former § 46(f)(1) provides that the ITC may not be used to reduce the taxpayer's cost of service, but may be used to reduce rate base, if such reduction is restored not less rapidly than ratably. Former § 46(f)(2) provides an election under which a taxpayer is permitted to take into account a ratable portion of the ITC for purposes of determining cost of service, but is not permitted to reduce the base to which the taxpayer's rate of return for ratemaking purposes is applied by any portion of the credit. A utility taxpayer elects either former § 46(f)(1) or former § 46(f)(2) and that choice applies to all public utility property of the taxpayer. A taxpayer that does not specifically elect former § 46(f)(2) is subject to the general rule of former § 46(f)(1).

Former § 46(f)(6) provides that for purposes of determining ratable portions, the period of time used in computing depreciation expense for purposes of reflecting operating results in the taxpayer's regulated books of account is to be used. Under § 1.46-6(g)(2) of the Income Tax Regulations, "ratable" is determined by considering the period of time actually used in computing the taxpayer's regulated depreciation expense for the property for which a credit is allowed. "Regulated depreciation expense" is the depreciation expense for the property used by a regulatory body for purposes of establishing the taxpayer's cost of service for ratemaking purposes.

.04 Application of Sanctions for Failure to Use a Normalization Method of Accounting. Former § 46(f)(4)(A) provides that there is no disallowance of a credit

before the first final inconsistent determination is put into effect for the taxpayer's former § 46(f) property. Section 1.46-6(f)(4) provides that the ITC is disallowed for any former § 46(f) property placed in service by a taxpayer (a) before the date a final inconsistent determination by a regulatory body is put into effect, and (b) on or after such date and before the date a subsequent consistent determination is put into effect.

Section 1.46-6(f)(7) provides that the term "determination" refers to a determination made with respect to former § 46(f) property (other than property to which an election under former § 46(f)(3) applies) by a regulatory body described in former § 46(c)(3)(B) that determines the effect of the credit (a) for purposes of former § 46(f)(1), on the taxpayer's cost of service or rate base for ratemaking purposes, or (b) for a taxpayer that made an election under former § 46(f)(2), on the taxpayer's cost of service, for ratemaking purposes or in its regulated books of account, or on the taxpayer's rate base for ratemaking purposes.

Section 1.46-6(f)(8)(i) provides that "inconsistent" refers to a determination that is inconsistent with former § 46(f)(1) or former § 46(f)(2). For example, a determination to reduce the taxpayer's cost of service by more than a ratable portion of the ITC would be a determination that is inconsistent with former § 46(f)(2). Section 1.46-6(f)(8)(ii) provides that the term "consistent" refers to a determination that is consistent with former § 46(f)(1) or former § 46(f)(2). Section 1.46-6(f)(8)(iii) provides that the term "final determination" means a determination by a regulatory body with respect to which all rights of appeal or to request a review, a rehearing, or a redetermination have been exhausted or have lapsed.

The Senate Finance Committee Report to the Tax Reduction Act of 1975 addressed the importance of the final determination by stating that "if a regulatory agency requires the flowing through of a company's additional investment credit at a rate faster than permitted, or insists upon a greater rate base adjustment than is permitted, the additional investment credit is to be disallowed, but only after a final determination . . . is put into effect." S. Rep. No. 94-36, at 44-45 (1975).

Unlike most tax provisions the sanctions imposed under the Normalization Rules were not intended to directly increase or decrease federal tax revenues. They were intended to discourage the flow through of tax benefits to customers in order to allow utilities to benefit from the underlying depreciation and ITC provisions and prevent the loss of revenue the federal government would suffer if the benefits were flowed through to customers.

In addition, in discussing the limitations on the ratemaking treatment of the ITC under § 46(e)(1) and (e)(2), the Senate Finance Committee Report concerning the Revenue Act of 1971, P.L. 92-178, 85 Stat. 497, indicates that the Committee hoped that the sanctions of disallowance of the ITC would not have to be imposed. S. Rep. No. 92-437, at 41 (1971).

SECTION 3. SCOPE

.01 This revenue procedure applies to a taxpayer that:

(1) owns Public Utility Property (as defined in section 4.03 of this revenue procedure);

(2) has inadvertently or unintentionally failed to follow a practice or procedure that

is consistent with the Normalization Rules (as defined in section 4.04 of this revenue procedure) in one or more years;

(3) upon recognizing its failure to comply with the Normalization Rules, the taxpayer changes its Inconsistent Practice or Procedure (as defined in section 4.06 of this revenue procedure) to a Consistent Practice or Procedure (as defined in section 4.05 of this revenue procedure) at the Next Available Opportunity (as defined in section 4.07 of this revenue procedure) in a manner that totally reverses the effect of the Inconsistent Practice or Procedure, provided the Taxpayer's Regulator (as defined in section 4.01 of this revenue procedure) adopts or approves the change; and

(4) retains contemporaneous documentation that clearly demonstrates the effects of the Inconsistent Practice or Procedure and the change to a Consistent Practice or Procedure adopted or approved by the Taxpayer's Regulator.

.02 For purposes of section 3.01(2) of this revenue procedure, a taxpayer's Inconsistent Practice or Procedure is neither inadvertent nor unintentional if the Taxpayer's Regulator specifically considered and specially addressed the application of the Normalization Rules to the Inconsistent Practice or Procedure in establishing or approving the taxpayer's rates even if at the time of such consideration the Taxpayer's Regulator did not believe the practice or procedure was inconsistent with the Normalization Rules.

SECTION 4. DEFINITIONS

.01 Taxpayer's Regulator

Taxpayer's Regulator 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 that establishes or approves the rates of the taxpayer.

.02 Rate Proceeding

Rate Proceeding means a proceeding in which the Taxpayer's Regulator establishes or approves the taxpayer's rates.

.03 Public Utility Property

Public Utility Property has the meaning provided in former § 46(f)(5) or in § 168(i)(l0), and the applicable Income Tax Regulations.

.04 Normalization Rules

The Normalization Rules mean, in the case of the ITC, the rules provided by former § 46(f), as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990, and the Income Tax Regulations thereunder, and, in the case of the accelerated cost recovery system for depreciation, the rules provided by § 168(i)(9), as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990, and the Income Tax Regulations thereunder.

.05 Consistent Practice or Procedure

A Consistent Practice or Procedure means a practice or procedure followed by the taxpayer and the Taxpayer's Regulator that is consistent with the Normalization Rules.

.06 Inconsistent Practice or Procedure

An Inconsistent Practice or Procedure means a practice or procedure followed by the taxpayer and the Taxpayer's Regulator that is inconsistent with the Normalization Rules.

.07 Next Available Opportunity

(1) In the case of a taxpayer without a Rate Proceeding pending before the Taxpayer's Regulator, the Next Available Opportunity means the next Rate Proceeding.

(2) In the case of a taxpayer with a Rate Proceeding currently pending before the Taxpayer's Regulator, the Next Available Opportunity means the currently pending proceeding, unless the rules of the Taxpayer's Regulator or applicable state or federal law (at the time the Inconsistent Practice or Procedure is identified) preclude the taxpayer from initiating a change from an Inconsistent Practice or Procedure to a Consistent Practice or Procedure in the currently pending proceeding, in which case the currently pending proceeding shall not be the Next Available Opportunity, and the Next Available Opportunity means the next Rate Proceeding.

(3) If, at the conclusion of a Rate Proceeding, the taxpayer has a private letter ruling request pending before the Service to address whether or not a practice or procedure addressed in the Rate Proceeding is a Consistent Practice or Procedure, and the Taxpayer's Regulator later establishes or approves rates subject to adjustment from the effective date of the unadjusted rates in order to conform to the Service's ruling, the taxpayer shall have corrected its Inconsistent Practice or Procedure at the Next Available Opportunity.

SECTION 5. APPLICATION

.01 For any taxpayer described in section 3 of this revenue procedure, the Service will not assert that the Inconsistent Practice or Procedure constitutes a violation of the Normalization Rules and will not deny that taxpayer the benefits of the ITC and/or

accelerated depreciation. In any tax year ending after the taxpayer has identified an Inconsistent Practice or Procedure, but in which the taxpayer has not changed to a Consistent Practice or Procedure because the taxpayer has not reached the year that presents the taxpayer with its Next Available Opportunity, the taxpayer must include in its return a statement described in section 5.02 of this revenue procedure. If the taxpayer makes the representation described in section 5.02(3) of this revenue procedure, the Service will not assert that the Inconsistent Practice or Procedure is a violation of the Normalization Rules and will not challenge the taxpayer's use of the identified Inconsistent Practice or Procedure unless the taxpayer does not change to a Consistent Practice or Procedure at the Next Available Opportunity.

.02 A statement is described in this section 5.02 if:

(1) The top of the statement is marked "FILED PURSUANT TO REV. PROC. 2017-47";

(2) The statement identifies the taxpayer's Inconsistent Practice or Procedure; and

(3) The statement includes a representation by the taxpayer of its intention to change to a Consistent Practice or Procedure at the Next Available Opportunity.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2016. However, the Service will not challenge any Inconsistent Practice or Procedure in any earlier taxable year provided that the requirements of sections 3 and 5 of this revenue procedure are satisfied by the taxpayer with respect to the

Inconsistent Practice or Procedure in such taxable year.

SECTION 7. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-2276.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information are in sections 3 and 5 of this revenue procedure and are required for a taxpayer to apply the safe harbor provided by this revenue procedure. This information is required to be collected and retained to clearly demonstrate the effects of a taxpayer's Inconsistent Practice or Procedure and the taxpayer's change to a Consistent Practice or Procedure adopted or approved by the Taxpayer's Regulator. The taxpayer must also include a statement in its federal income tax return identifying the Inconsistent Practice or Procedure and representing its intention to change to a Consistent Practice or Procedure at the Next Available Opportunity. The likely respondents are corporations or partnerships that are regulated public utilities.

The estimated total annual reporting burden is 1,800 hours.

The estimated annual burden per respondent varies from 10 hours to 14 hours, depending on individual circumstances, with an estimated average burden of 12 hours to collect and retain contemporaneous documentation and to complete the statement required under this revenue procedure. The estimated number of respondents is 150.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by § 6103.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Jennifer C. Bernardini of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure contact Ms. Bernardini on (202) 317-6853 (not a toll free call).