

BUTLER | SNOW

June 7, 2018

**VIA ELECTRONIC FILING**

Hon. David Jones, Chairman  
c/o Sharla Dillon  
Tennessee Public Utilities Commission  
502 Deaderick Street, 4<sup>th</sup> Floor  
Nashville, TN 37243

**RE: *Petition of Tennessee-American Water Company in Support of the Calculation of the 2018 Capital Recovery Riders Reconciliation, Docket No. 18-00022***

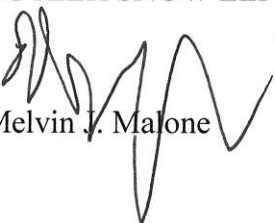
Dear Chairman Jones:

Attached for filing please find *Tennessee-American Water Company's Responses to Request Nos. 10 and 11 to the Third Discovery Requests of the Consumer Protection and Advocate Division* in the above-captioned matter.

As required, an original of this filing, along with four (4) hard copies, will follow. Should you have any questions concerning this filing, or require additional information, please do not hesitate to contact me.

Very truly yours,

BUTLER SNOW LLP



Melvin J. Malone

clw

Attachments

cc: Linda Bridwell, Tennessee-American Water Company (via e-mail)  
Daniel Whitaker, Assistant Attorney General, Consumer Protection and Advocate Division (via email)  
Karen H. Stachowski, Assistant Attorney General, Consumer Protection and Advocate Division (via email)

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BUTLER SNOW LLP

**TENNESSEE AMERICAN WATER COMPANY  
DOCKET NO. 18-00022  
THIRD DISCOVERY REQUEST OF THE  
CONSUMER ADVOCATE AND PROTECTION DIVISION**

**Responsible Witness:**         **Linda C. Bridwell**

**Question:**

10. Refer to the response supplied in response and attachment to CPAD 1-3 in the current docket, as well as the response to CPAD 1-16 in Docket No. 17-00124. In its response to 1-16 in Docket No. 17-00124, TAWC acknowledged that it claimed bonus depreciation for all years contained within this capital rider recovery period. Does TAWC believe that it would be appropriate to replace the existing ADIT balances contained in the Rider application (which reflect neither Bonus Depreciation nor the Repair Allowance) with the calculations contained within the attachment to CPAD 1-3?
  - a. If TAWC does not believe this adjustment to be appropriate, provide a comprehensive explanation for this position, given the taxable income results provided within the response to CPAD Discovery Request 1-2 in this Docket. Provide any Private Letter Rulings issued by the IRS which support the conclusion that Bonus Depreciation should not be incorporated into the ADIT calculations included in this filing.
  - b. If TAWC believes the NOL position of the company should be considered based upon TAWC results occurring prior to the effective date of the Capital Riders, provide a comprehensive explanation supporting this position. Provide any Private Letter Rulings issued by the IRS, as well as any other documents, which support this position.
  - c. If TAWC believes that the NOL balances occurring during the period of the capital rider should be considered, provide the calculation of the NOL TAWC believes should apply to the capital riders, including all supporting workpapers. Further, reconcile the taxable income amounts provided in the confidential attachments to CPAD 1-2 to the proposed NOL that should be considered within this application. Provide any Private Letter Rulings issued by the IRS which support TAWC's position.

**Response:**

- a. TAWC does not agree that bonus depreciation and repairs deductions should be added to the calculation of Accumulated Deferred Income Tax in the Capital Recovery Riders for a number of reasons.

First, the purpose of a capital rider is to create a simple adjustment mechanisms that allows for recovery of critical infrastructure investment without the complexity and customer cost of a rate case. The current surcharge calculation for ADIT (Accumulated Deferred Income Taxes) examines book depreciation compared to MACRS (Modified Accelerated Cost Recovery System) depreciation. This is a more reasonable approach which is why TAWC proposed to include the difference between MACRS and book depreciation in the Capital Recovery Riders calculations. MACRS has been in place since 1986, creating stability and predictability in the figures for the last thirty years. In contrast, both bonus deductions (Bonus Depreciation and Repairs) have been unpredictable over time. Bonus depreciation has been inconsistently authorized over the last decade, and at this point has been virtually eliminated. In fact, for utility projects commenced after September 27, 2017, bonus depreciation is no longer allowed. Additionally, book vs. MACRS differences are not generally large enough to trigger a Net Operating Loss (NOL), whereas the inclusion of bonus and repairs can trigger an NOL. NOLs significantly complicate the tax calculations.

Secondly, the capital riders already include a provision for an Earnings Test Adjustment. The Earnings Test Adjustment will not make the Company whole when it falls short of earning its authorized return. However, if any tax policies or deductions cause the Company to earn above its authorized return, the current regulatory process for Capital Recovery Rider approval assures that the Company does not earn above its authorized rate of return and provides a credit to customers. Because the earnings test is already included in the mechanism, there is no need to add further complexity to the review process by introducing unstable deductions and the evaluation of net operating losses.

If the TPUC were to decide to include bonus and repairs in the ADIT calculation, the NOL should also be included. Please see TAW TAW\_R\_CPADDR3\_NUM010\_060618\_Attachment 1.xlsx.

- b. TAWC does not believe it is appropriate to include NOL generated prior to the start of the Capital Recovery Riders, and none is being included in the calculation provided as Attachment 1. The NOL is only generated based on the applicable financial information included in the Capital Recovery Riders.

To support that calculation, TAWC has modified the calculation provided in response to Item 3 of the CPAD's First Discovery Request in this Docket. See Attachment 1 labeled TAW\_R\_CPADDR3\_NUM010\_060618\_Attachment 1 for the calculation of the effect of including all the pieces mentioned above.

- c. TAWC believes that if it is determined that Bonus Depreciation and Repairs deductions should be included, then NOL for the time period should also be included. As stated in the responses to Items 1 and 3 of the CPAD's First Discovery Request in this Docket, the assets in the Capital Recovery Riders are not maintained separately from the total TAWC assets and therefore the Capital Recovery Riders

cannot be reconciled to the results of the tax returns provided in response to Item 2 of the CPAD's First Discovery Request in this Docket. As such, the cumulative NOL from the tax returns is not used in this calculation but is calculated based upon the activity in the Riders only. Please refer to the Attachment 1 for this calculation.

Please see Attachment 2 for two of many Private Letter Rulings issued by the IRS in recent years that support our position of including the NOL in the Capital Recovery Rider calculation of ADIT.

Tennessee American Water Company  
Capital Riders' Filing  
Calculation of ADIT with Bonus, Repairs and NOL  
For the Years Ended 2014-2017

		Actual Docket # 15-00029 2014	Actual Docket # 16-00022 2015	Actual Docket # 17-00020 2016	Actual Docket # 18-00022 2017
Revenue		\$338,645	\$1,481,559	\$4,426,167	\$6,222,731
Depreciation Expense		(39,779)	(294,063)	(849,206)	(1,206,475)
Property Tax and Franchise Taxes		(42,173)	(164,209)	(491,132)	(642,312)
Revenue Tax (Uncoll, Forfeited Discounts, GR)	3.191%	(10,806)	(47,277)	(141,239)	(198,567)
Interest Expense		(119,519)	(480,446)	(1,481,996)	(1,949,653)
Book Income before Income Tax		126,368	495,564	1,462,594	2,225,724
State Book/Tax Adjustment-Depr.		(1,588,066)	(4,640,299)	(5,143,973)	(5,424,055)
State Taxable Gain(Loss)		(1,461,698)	(4,144,735)	(3,681,379)	(3,198,332)
State Current Tax Expense (Benefit)	6.500%	(95,010)	(269,408)	(239,290)	(207,892)
Federal Book/Tax Adjustment-Depr.		(4,117,464)	(10,476,054)	(6,416,820)	(8,240,899)
Federal Taxable Gain(Loss)		(3,896,085)	(9,711,082)	(4,714,936)	(5,807,284)
Federal Current Tax Expense (Benefit)	35.000%	(1,363,630)	(3,398,879)	(1,650,228)	(2,032,549)
State Current Tax Expense (Benefit)	6.500%	(95,010)	(269,408)	(239,290)	(207,892)
Federal Deferred Tax Expense		1,404,984	3,561,052	2,128,862	2,760,918
State Deferred Tax Expense		103,224	301,619	334,358	352,564
Total Tax Expense		49,568	194,385	573,703	873,040
NOL Build (Use)		1,458,640	3,668,287	1,889,517	2,240,441
<b>Balance Sheet:</b>					
Deferred Tax Liability (credit balance)		(1,508,208)	(5,370,880)	(7,834,100)	(10,947,581)
Deferred Tax Asset		1,458,640	5,126,927	7,016,444	9,256,885
<b>Net Liability (liab = credit balance)</b>		<b>(49,568)</b>	<b>(243,953)</b>	<b>(817,656)</b>	<b>(1,690,696)</b>
<b>Interest Expense Calc:</b>					
		2014	2015	2016	2017
Annual Interest Rate		3.80%	3.80%	3.80%	3.80%
Average Rate Base		3,149,357	12,659,938	39,051,132	51,374,087
Interest Expense		119,519	480,446	1,481,996	1,949,653

Tennessee American Water Company  
Capital Riders' Filing  
Calculation of Book/Tax Depreciation and Repair Differences  
For the Years Ended 2014-2017

**CALCULATION OF TAX DEPR with Bonus & Repairs:**

	2014 5 Year	2014 25 Year	2014 39 Year	2014 Total	2015 5 Year	2015 25 Year	2015 39 Year	2015 Total
UPIS ADDITIONS	219,399	6,465,466	138,428		261,975	14,547,173	9,555,958	
CIAC BALANCE	-	-	-		-	-	-	
GRAND TOTAL BALANCE	219,399	6,465,466	138,428		261,975	14,547,173	9,555,958	
REPAIRS		1,482,531				2,576,304	1,692,360	
UPIS TAX BASIS BALANCE	219,399	4,982,935	138,428		261,975	11,970,869	7,863,598	
UPIS TAX BASIS BALANCE AFTER BONUS DEPR	50% 109,699	2,491,467	138,428		130,988	5,985,434	7,863,598	
Tax Rate Year 1	20.00%	2.00%	1.28%		20.00%	2.00%	1.28%	
Tax Rate Year 2	32.00%	4.00%	2.56%		32.00%	4.00%	2.56%	
Tax Rate Year 3	19.20%	4.00%	2.56%		19.20%	4.00%	2.56%	
Tax Rate Year 4	11.52%	4.00%	2.56%		11.52%	4.00%	2.56%	

**Book/Tax Adjustment-Depr. Calculation**

Repairs	-	(1,482,531)	-		-	(2,576,304)	(1,692,360)	
Bonus Depreciation (rate x additions)	(109,700)	(2,491,468)	-		(130,987)	(5,985,435)	-	
Regular Yr 1 tax depreciation	(21,940)	(49,829)	(1,775)		(26,198)	(119,709)	(100,811)	
Regular Yr 2 tax depreciation					(35,104)	(99,659)	(3,549)	
Regular Yr 3 tax depreciation								
Regular Yr 4 tax depreciation								
Book Depreciation		39,779				294,063		
Net book/tax difference	(131,640)	(3,984,049)	(1,775)	(4,117,464)	(192,289)	(8,487,044)	(1,796,720)	(10,476,054)

Tennessee American Water Company  
Capital Riders' Filing  
Calculation of Book/Tax Depreciation and Repair Differences  
For the Years Ended 2014-2017

**CALCULATION OF TAX DEPR with Bonus & Repairs:**

					Prior to October				After to October		
	2016 5 Year	2016 25 Year	2016 39 Year	2016 Total	2017 3 Year	2017 5 Year	2017 25 Year	2017 39 Year	2017 Total	2017 3 Year	2017 5 Year
UPIS ADDITIONS	180,161	5,603,587	8,289,269		100,405	372,571	11,743,085	(4,368,259)		-	294,535
CIAC BALANCE	-	(497,284)	-		-	-	(1,718,549)	-		-	-
GRAND TOTAL BALANCE	180,161	5,106,303	8,289,269		100,405	372,571	10,024,536	(4,368,259)		-	294,535
REPAIRS		1,835,205	2,979,163				3,026,407				
UPIS TAX BASIS BALANCE	180,161	3,271,097	5,310,105		100,405	372,571	6,998,128	(4,368,259)		-	294,535
UPIS TAX BASIS BALANCE AFTER BONUS DEPR	50% 90,080	1,635,549	5,310,105		100,405	186,285	3,499,064	(4,368,259)		-	294,535
Tax Rate Year 1	20.00%	2.00%	1.28%		33.33%	20.00%	2.00%	1.28%		33.33%	20.00%
Tax Rate Year 2	32.00%	4.00%	2.56%		33.33%	32.00%	4.00%	2.56%		33.33%	32.00%
Tax Rate Year 3	19.20%	4.00%	2.56%		33.34%	19.20%	4.00%	2.56%		33.34%	19.20%
Tax Rate Year 4	11.52%	4.00%	2.56%			11.52%	4.00%	2.56%			11.52%

**Book/Tax Adjustment-Depr. Calculation**

Repairs	-	(1,835,205)	(2,979,163)			-	(3,026,407)	-		-
Bonus Depreciation (rate x additions)	(90,081)	(1,635,548)	-			(186,286)	(3,499,064)	-		-
Regular Yr 1 tax depreciation	(18,016)	(32,711)	(68,076)		(33,465)	(37,257)	(69,981)	56,001		(58,907)
Regular Yr 2 tax depreciation	(41,916)	(239,417)	(201,623)			(28,826)	(65,422)	(136,151)		
Regular Yr 3 tax depreciation	(21,062)	(99,659)	(3,549)			(25,150)	(239,417)	(201,623)		
Regular Yr 4 tax depreciation						(12,637)	(99,659)	(3,549)		
Book Depreciation		849,206					1,206,475			
Net book/tax difference	(171,075)	(2,993,335)	(3,252,411)	(6,416,820)	(33,465)		(5,793,476)	(285,322)	(6,112,263)	-
										(58,907)

Tennessee American Water Company  
Capital Riders' Filing  
Calculation of Book/Tax Depreciation and Repair Differences  
For the Years Ended 2014-2017

**CALCULATION OF TAX DEPR with Bonus & Repairs:**

	2017 25 Year	2017 39 Year	2017 Total
UPIS ADDITIONS	5,534,138	1,127,247	
CIAC BALANCE	(90,857)	-	
GRAND TOTAL BALANCE	5,443,281	1,127,247	
REPAIRS	1,643,326	340,316	
UPIS TAX BASIS BALANCE	3,799,954	786,931	
UPIS TAX BASIS BALANCE AFTER BONUS DEPR	50% 3,799,954	786,931	
Tax Rate Year 1	2.00%	1.28%	
Tax Rate Year 2	4.00%	2.56%	
Tax Rate Year 3	4.00%	2.56%	
Tax Rate Year 4	4.00%	2.56%	

**Book/Tax Adjustment-Depr. Calculation**

Repairs	(1,643,326)	(340,316)	
Bonus Depreciation (rate x additions)	-	-	
Regular Yr 1 tax depreciation	(75,999)	(10,088)	
Regular Yr 2 tax depreciation			
Regular Yr 3 tax depreciation			
Regular Yr 4 tax depreciation			
Book Depreciation			
Net book/tax difference	(1,719,325)	(350,404)	(2,128,636)



Tennessee American Water Company  
Capital Riders' Filing  
Calculation of Book/Tax Depreciation and Repair Differences  
For the Years Ended 2014-2017

**CALCULATION OF TAX DEPR with Bonus & Repairs:**

	2014 5 Year	2014 25 Year	2014 39 Year	2014 Total	2015 5 Year	2015 25 Year	2015 39 Year	2015 Total
UPIS ADDITIONS	219,399	6,465,466	138,428		261,975	14,547,173	9,555,958	
CIAC BALANCE	-	-	-		-	-	-	
GRAND TOTAL BALANCE	219,399	6,465,466	138,428		261,975	14,547,173	9,555,958	
REPAIRS	-	1,482,531	-		-	2,576,304	1,692,360	
UPIS TAX BASIS BALANCE	219,399	4,982,935	138,428		261,975	11,970,869	7,863,598	
UPIS TAX BASIS BALANCE AFTER BONUS DEPR	100% 219,399	4,982,935	138,428		261,975	11,970,869	7,863,598	
Tax Rate Year 1	20.00%	2.00%	1.28%		20.00%	2.00%	1.28%	
Tax Rate Year 2	32.00%	4.00%	2.56%		32.00%	4.00%	2.56%	
Tax Rate Year 3	19.20%	4.00%	2.56%		19.20%	4.00%	2.56%	
Tax Rate Year 4	11.52%	4.00%	2.56%		11.52%	4.00%	2.56%	

**Book/Tax Adjustment-Depr. Calculation**

Repairs	-	(1,482,531)	-		-	(2,576,304)	(1,692,360)	
Bonus Depreciation (rate x additions)	0	0	-		(0)	0	-	
Regular Yr 1 tax depreciation	(43,880)	(99,659)	(1,775)		(52,395)	(239,417)	(100,811)	
Regular Yr 2 tax depreciation					(70,208)	(199,317)	(3,549)	
Regular Yr 3 tax depreciation								
Regular Yr 4 tax depreciation								
Book Depreciation		39,779				294,063		
Net book/tax difference	(43,880)	(1,542,411)	(1,775)	(1,588,066)	(122,603)	(2,720,975)	(1,796,720)	(4,640,299)

Tennessee American Water Company  
Capital Riders' Filing  
Calculation of Book/Tax Depreciation and Repair Differences  
For the Years Ended 2014-2017

**CALCULATION OF TAX DEPR with Bonus & Repairs:**

					Prior to October				After to October		
	2016	2016	2016	2016	2017	2017	2017	2017	2017	2017	2017
	5 Year	25 Year	39 Year	Total	3 Year	5 Year	25 Year	39 Year	Total	3 Year	5 Year
UPIS ADDITIONS	180,161	5,603,587	8,289,269		100,405	372,571	11,743,085	(4,368,259)			294,535
CIAC BALANCE	-	(497,284)	-		-	-	(1,718,549)	-		-	-
GRAND TOTAL BALANCE	180,161	5,106,303	8,289,269		100,405	372,571	10,024,536	(4,368,259)		-	294,535
REPAIRS	-	1,835,205	2,979,163		-	-	3,026,407	-		-	-
UPIS TAX BASIS BALANCE	180,161	3,271,097	5,310,105		100,405	372,571	6,998,128	(4,368,259)		-	294,535
UPIS TAX BASIS BALANCE AFTER BONUS DEPR	100%	180,161	3,271,097	5,310,105	100,405	372,571	6,998,128	(4,368,259)		-	294,535
Tax Rate Year 1	20.00%	2.00%	1.28%		33.33%	20.00%	2.00%	1.28%		33.33%	20.00%
Tax Rate Year 2	32.00%	4.00%	2.56%		33.33%	32.00%	4.00%	2.56%		33.33%	32.00%
Tax Rate Year 3	19.20%	4.00%	2.56%		33.34%	19.20%	4.00%	2.56%		33.34%	19.20%
Tax Rate Year 4	11.52%	4.00%	2.56%			11.52%	4.00%	2.56%			11.52%

**Book/Tax Adjustment-Depr. Calculation**

Repairs	-	(1,835,205)	(2,979,163)			-	(3,026,407)	-			-
Bonus Depreciation (rate x additions)	0	(0)	-			0	(0)	-			-
Regular Yr 1 tax depreciation	(36,032)	(65,422)	(68,076)		(33,465)	(74,514)	(139,963)	56,001			(58,907)
Regular Yr 2 tax depreciation	(83,832)	(478,835)	(201,623)			(57,652)	(130,844)	(136,151)			
Regular Yr 3 tax depreciation	(42,125)	(199,317)	(3,549)			(50,299)	(478,835)	(201,623)			
Regular Yr 4 tax depreciation						(25,275)	(199,317)	(3,549)			
Book Depreciation		849,206					1,206,475				
Net book/tax difference	(161,989)	(1,729,574)	(3,252,411)	(5,143,973)	(33,465)	(207,740)	(2,768,892)	(285,322)	(3,295,419)	-	(58,907)

Tennessee American Water Company  
Capital Riders' Filing  
Calculation of Book/Tax Depreciation and Repair Differences  
For the Years Ended 2014-2017

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	2017 25 Year	2017 39 Year	2017 Total
UPIS ADDITIONS	5,534,138	1,127,247	
CIAC BALANCE	(90,857)	-	
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REPAIRS	1,643,326	340,316	
UPIS TAX BASIS BALANCE	3,799,954	786,931	
UPIS TAX BASIS BALANCE AFTER BONUS DEPR	100% 3,799,954	786,931	
Tax Rate Year 1	2.00%	1.28%	
Tax Rate Year 2	4.00%	2.56%	
Tax Rate Year 3	4.00%	2.56%	
Tax Rate Year 4	4.00%	2.56%	

**Book/Tax Adjustment-Depr. Calculation**

Repairs	(1,643,326)	(340,316)	
Bonus Depreciation (rate x additions)	-	-	
Regular Yr 1 tax depreciation	(75,999)	(10,088)	
Regular Yr 2 tax depreciation			
Regular Yr 3 tax depreciation			
Regular Yr 4 tax depreciation			
Book Depreciation			
Net book/tax difference	(1,719,325)	(350,404)	(2,128,636)

## **IRS Letter Rulings and TAMS (Current), UIL No. 0167.22-01 Depreciation; Public utility property; Normalization rules. IRS Letter Ruling 201436037 (May. 22, 2014), Internal Revenue Service, (May 22, 2014)**

[Click to open document in a browser](#)

LTR 201436037, May 22, 2014

Symbol: CC:PSI:B06-PLR-148310-13

### **Uniform Issue List No. 0167.22-01**

[\[Code Sec. 167\]](#)

#### **Depreciation; Public utility property; Normalization rules.**

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

The representations set out in your letter follow.

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

Taxpayer filed a general rate case with Commission B on Date A (Case). The test year used in the Case was the 12 month period ending on Date B. In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized in accordance with Commission B policy and were not flowed thru to ratepayers. The data originally filed in Case included six months of forecast data, which the Taxpayer updated with actual data in the course of proceedings. In establishing the rate base on which Taxpayer was to be allowed to earn a return Commission B offset rate base by Taxpayer's ADIT balance, using a 13-month average of the month-end balances of the relevant accounts. Taxpayer argued that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Testimony by various other participants in Case argued against Taxpayer's proposed calculation of ADIT. One proposal made to Commission B was, if Commission B allowed Taxpayer to reduce the ADIT balance as Taxpayer proposed, then Taxpayer's income tax expense element of service should be reduced by that same amount.

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

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

Taxpayer requests that we rule as follows:

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

#### **LAW AND ANALYSIS**

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

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

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

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

pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

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

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

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

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

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

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

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

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

Regarding the second issue, § 1.167(1)-(h)(6)(i) provides, as noted above, that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Increasing Taxpayer's ADIT account by an amount representing those taxes that would have been deferred absent the NOLC increases the ADIT reserve account (which will then reduce rate base) beyond the permissible amount.

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

We rule as follows:

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

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

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

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of

this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely, Peter C. Friedman, Senior Technician Reviewer, Branch 6 (Passthroughs & Special Industries).

cc: \*\*\*\*\*



## **IRS Letter Rulings and TAMS (Current), UIL No. 0167.22-01 Depreciation; Public utility property; Normalization rules. IRS Letter Ruling 201709008 (Dec. 02, 2016), Internal Revenue Service, (Dec. 2, 2016)**

[Click to open document in a browser](#)

LTR 201709008, December 02, 2016

Symbol: CC:PSI:B06-PLR-119381-16

### **Uniform Issue List No. 0167.22-01**

[\[Code Sec. 167\]](#)

#### **Depreciation; Public utility property; Normalization rules.**

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

The representations set out in your letter follow.

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

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

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

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

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

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

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

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

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

Taxpayer requests that we rule as follows:

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

#### **LAW AND ANALYSIS**

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

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

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

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

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

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

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

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

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

Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and

ratemaking purposes. Taxpayer has done so. Section 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.

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

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

We rule as follows:

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

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

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

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

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

CC: \*\*\*\*\*

**TENNESSEE AMERICAN WATER COMPANY  
DOCKET NO. 18-00022  
THIRD DISCOVERY REQUEST OF THE  
CONSUMER ADVOCATE AND PROTECTION DIVISION**

**Responsible Witness:**         **Linda C. Bridwell**

**Question:**

11.     Refer to page 11 of Ms. Bridwell's rebuttal testimony in Docket No. 17-00124. Is it Ms. Bridwell's position that an NOL attributed to periods prior to the initiation of the Capital Riders should be used to increase the Capital Rider rate base? If so, provide all Private Letter Rulings issued by the IRS, as well as any other documents, which support this position.

**Response:**

No it is not Ms. Bridwell's nor the Company's position that an NOL attributable to periods prior to the initiation of the Capital Recovery Riders increase rate base in the Capital Recovery Riders. Since the financial results that generated those prior NOL's are not included in the Capital Recovery Riders it would not be appropriate to include it. Please also refer to Attachment 2 in provided in response to Item 10 of the CPAD's same Third Discovery Request in this Docket.

STATE OF Kentucky )  
COUNTY OF Fayette )

BEFORE ME, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared Linda C. Bridwell, being by me first duly sworn deposed and said that:

She is appearing as a witness on behalf of Tennessee-American Water Company before the Tennessee Public Utility Commission, and if present before the Commission and duly sworn, the data requests responses are accurate to the best of her knowledge.

Linda C. Bridwell  
Linda C. Bridwell

Sworn to and subscribed before me  
this 1st day of June, 2018.

Sharon Miller  
Notary Public

My Commission Expires: 7/25/2020

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail or electronic mail upon:

Daniel Whitaker III, Esq.  
Assistant Attorney General  
Office of the Tennessee Attorney General  
Consumer Protection and Advocate Division  
P.O. Box 20207  
Nashville, TN 37202-0207  
[Daniel.Whitaker@ag.tn.gov](mailto:Daniel.Whitaker@ag.tn.gov)

Karen H. Stachowski  
Assistant Attorney General  
Office of the Tennessee Attorney General  
Consumer Protection and Advocate Division  
P.O. Box 20207  
Nashville, TN 37202-0207  
[Karen.Stachowski@ag.tn.gov](mailto:Karen.Stachowski@ag.tn.gov)

This the 7<sup>th</sup> day of June, 2018.

  
\_\_\_\_\_  
Melvin J. Malone