Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Date:
July 18, 2018

LEGEND

Taxpayer	=
Parent	=
State A	=
State B	=
Commission A	=
Commission B	=
Director	=
Year 1	=
Year 2	=
Year 3	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=

Date 5 =

a =

b =

c =

d =

Dear :

This letter responds to a request for a private letter ruling dated November 27, 2017, submitted on behalf of Taxpayer by your authorized representatives. Taxpayer requested a ruling regarding the application of the normalization rules under § 168(i)(9) of the Internal Revenue Code and § 1.167(l)-1 of the Income Tax Regulations (the normalization requirements.) The relevant facts as represented in your submissions are set forth below.

FACTS

Parent is a publicly traded holding company incorporated in State A. Parent is the parent of a group of affiliated companies, which includes Taxpayer, that electronically file a consolidated federal income tax return using an accrual basis of accounting and a calendar year for both tax and financial reporting purposes. Parent is under the audit jurisdiction of LB&I. Taxpayer is a vertically-integrated, cost-based, rate-regulated electric utility, providing retail electric service in State B. Taxpayer is subject to regulation by Commission A with respect to its retail electric rates and by Commission B with respect to its wholesale rates. Taxpayer is a wholly owned subsidiary of Parent.

Parent consolidated group made first and second quarter Year 2 estimated tax payments to the Internal Revenue Service (Service), part of which was Taxpayer's respective share. Parent's Year 1 federal income tax return was filed on Date 1 showing an overpayment which was applied to Year 2 estimated taxes. Part of the Year 1 overpayment was Taxpayer's share causing the Taxpayer's share of the total Year 2 federal estimated tax payments to be in the amount of a (Year 2 ES Payment). As of the filing date of the Year 1 consolidated return and the application of the Year 1 overpayment to Parent group's Year 2 estimated taxes, the additional 50% first year depreciation deduction ("Bonus Depreciation") was not applicable to otherwise qualified property (except long production period property). Accordingly, Taxpayer's Year 2 ES Payment was calculated without regard to Bonus Depreciation for Taxpayer's qualified property placed in service in the Year 2 tax year (other than long production period property).

On December 19, 2014, the Tax Increase Prevention Act of 2014 (P.L. 113-295) (the “2014 Tax Act”) was enacted into law, which, among other things, retroactively extended the option to elect Bonus Depreciation for all qualified property placed in service before January 1, 2014. After the enactment of the 2014 Tax Act, Parent decided that it would elect Bonus Depreciation for the consolidated group’s Year 2 federal income tax return. As a result of its decision to elect Bonus Depreciation for the Year 2 tax year, Taxpayer’s Year 2 ES Payment was in excess of the required amount had Bonus Depreciation not been elected in the amount of b (the Year 2 Tax Overpayment.) On Date 2, Taxpayer filed a refund claim with the Service for the Year 2 Tax Overpayment. Taxpayer recorded entries on its financial books of account that had net effect of not decreasing rate base by the amount of the tax refund claimed but not yet received by Taxpayer.

Taxpayer received a refund of the Year 2 Tax Overpayment from the Service on Date 3.

Similarly, for the Year 3 tax year, Parent consolidated group made first and second quarter Year 3 estimated tax payments to the Service, part of which was Taxpayer’s respective share. Taxpayer’s share of the total Year 3 federal estimated tax payments was in the amount of c (the Year 3 ES Payment). Similar to what occurred in the previous year, as of the filing date of the Year 2 consolidated return and the application of the Year 2 overpayment to Parent group’s Year 3 estimated taxes, Bonus Depreciation was not applicable to otherwise qualified property (except long production period property). Accordingly, Taxpayer’s Year 3 ES Payment was calculated without regard to Bonus Depreciation for Taxpayer’s qualified property placed in service in the Year 3 tax year (other than long production period property.)

On December 18, 2015, the Protecting Americans from Tax Hikes (PATH) Act of 2015 (P.L. 114-113) (the “2015 Tax Act”) was enacted into law, which, among other things, retroactively extended the option to elect Bonus Depreciation for all qualified property placed in service before January 1, 2016. After the enactment of the 2015 Tax Act, Parent decided that it would elect Bonus Depreciation for the consolidated group’s Year 3 federal income tax return. As a result of its decision to elect Bonus Depreciation for the Year 3 tax year, Taxpayer’s Year 3 ES Payment was in excess of the required amount had Bonus Depreciation not been elected in the amount of d (the Year 3 Tax Overpayment.) On Date 4, Taxpayer filed a refund claim with the Service for the Year 3 Tax Overpayment.). Taxpayer recorded entries on its financial books of account had the net effect of not decreasing rate base by the amount of the tax refund claimed but not yet received by Taxpayer.

Taxpayer received a refund of the Year 3 Tax Overpayment from the Service on Date 5.

RULING REQUESTED

A net reduction of rate base by means of including in Taxpayer's ADIT Account tax benefits resulting from timing differences due to depreciation that have not yet been received by Taxpayer and are not offset by a corresponding regulatory asset does not comply with the normalization requirements.

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

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

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

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

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

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

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

Similar to a taxpayer that must take into account the portion of a NOLC that is attributable to accelerated depreciation in calculating the amount of the ADIT under § 1.167(l)-1(h)(1)(iii), a taxpayer's reserve for deferred taxes for normalization purposes should include only amounts of tax that are actually deferred and amounts of zero-cost capital that are actually received. In this case, prior to the Service refunding the Year 2 Tax Overpayment and Year 3 Tax Overpayment, these were not in the possession of the Taxpayer. Taxpayer used different regulatory accounts to reflect the tax refund claimed but not yet received in Year 2 and Year 3; in both years, however, the net effect of the entries was to not reduce Taxpayer's rate base by the amount of the refund claimed but not yet received. A net reduction of rate base by means of including in Taxpayer's ADIT Account tax benefits resulting from timing differences due to depreciation that have not yet been received by Taxpayer and are not offset by a corresponding regulatory asset does not comply with the normalization requirements.

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

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

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

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to Director.

Sincerely,

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