DUKE ENERGY
FLORIDA

Dianne M. Triplett
DEPUTY GENERAL COUNSEL

March 9, 2022

VIA ELECTRONIC FILING

Adam J. Teitzman, Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: *Consideration of the tax impacts associated with Tax Cuts and Jobs Act of 2017 for Duke Energy Florida, LLC;* Docket No. 20180047-EI

Dear Mr. Teitzman:

Enclosed for electronic filing is a Joint Motion by Duke Energy Florida, LLC, and Citizens of Florida through Office of Public Counsel to Approve Treatment of Cost Removal and Close the Docket.

Thank you for your assistance in this matter. Please feel free to call me at (727) 820-4692 should you have any questions concerning this filing.

Sincerely,

/s/ Dianne M. Triplett

Dianne M. Triplett

DMT/mw
Enclosure

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Consideration of the tax impacts associated with Tax Cuts and Jobs Act of 2017 for Duke Energy Florida, LLC.	Docket No. 20180047-EI Dated: March 9, 2022

JOINT MOTION BY DUKE ENERGY FLORIDA, LLC, AND CITIZENS OF FLORIDA THROUGH OFFICE OF PUBLIC COUNSEL TO APPROVE TREATMENT OF COST OF REMOVAL AND CLOSE THE DOCKET

Duke Energy Florida, LLC, ("DEF") and the Citizens of Florida through the Office of Public Counsel ("OPC") (collectively the "Joint Movants"), pursuant to Rule 28-106.204, Florida Administrative Code, hereby move the Commission to approve DEF's proposed treatment of Excess Deferred Income Tax ("EDIT") related to cost of removal ("COR") as being protected and determine that the proposed treatment satisfies DEF's obligations with respect to the Stipulations approved in Order No. PSC-2019-0053-FOF-EI. Approval of this Motion will resolve all remaining issues in this docket and allow the Commission to close the docket. In support of this Motion, the Joint Movants state:

1. The Commission opened this docket to consider the impacts of the Tax Cuts and Jobs Act ("Tax Act") on DEF. In Order No. PSC-2019-0053-FOF-EI, the Commission approved stipulated positions agreed upon by OPC and DEF. The other parties to this proceeding, the Florida Industrial Power Users Group ("FIPUG"), the Florida Retail Federation ("FRF") and PCS Phosphate d/b/a White Springs ("PCS Phosphate") took no position on the Stipulations, but they did not object to the Commission's approval of the Stipulations.

2. Two of the Stipulations provided that DEF did not object to taking certain actions with respect to the treatment of COR. Specifically:

> Issue 1h: Should DEF seek a private letter ruling from the IRS regarding its classification of the excess ADIT [accumulated deferred income tax] relating to cost of removal/negative net salvage as primarily "protected"?
> Stipulation: Yes. DEF does not object to seeking a PLR from the IRS regarding its classification of the excess ADIT relating to cost of removal/negative net salvage as primarily protected.
>
> Issue 1i: If DEF seeks a private letter ruling and the IRS rules therein (or in another private letter ruling) that the excess ADIT relating to cost of removal/negative net salvage is to be treated as "unprotected", what process should be followed for the reclassification?
> Stipulation: If DEF receives a private letter ruling ("PLR") from the IRS ruling that excess ADIT relating to cost of removal/negative net salvage is to be treated entirely as unprotected, then a reclassification should be made in the company's books and records and flow-back amounts should be trued up retroactive to January 2018 based on the ruling.

3. The order also held the docket open, pending the resolution of the COR issue referenced in the above Issues 1h and 1i. Specifically, the Commission ordered that:

> ORDERED that this docket shall remain open to consider feedback from the Internal Revenue Service through the Private Letter Ruling regarding whether the treatment of excess accumulated deferred income taxes relating to the cost of removal/negative net salvage as unprotected is appropriate and until all true-ups and offsets are fully implemented pursuant to the 2017 Second Revised and Restated Settlement Agreement and the Implementation Stipulation regarding Tax Cuts and Jobs Act of 2017

This Motion is intended to provide and provide the feedback expected by the Commission and the resolution of these issues, such that the docket may be closed.

4. DEF began the process of seeking a PLR in 2019 but halted that process when the IRS notified utilities that it would not issue separate PLRs, but instead would issue guidance on industry matters resulting from the Tax Act. However, when the IRS issued Revenue Procedure 2020-39 on the Tax Act, it did not address COR.

5. Later the IRS released PLRs 202033002 and 202124003, stating that separately stated COR excess deferred income tax (EDIT) is not protected by the normalization rules. These two PLRs are attached to this Motion as Exhibit A. Of note, DEF's EDIT related to COR was not (and is still not) separately stated. It was (and remains) combined with salvage ("cost of removal/negative net salvage") and was allocated primarily to protected EDIT. This is the feedback that was contemplated. This Motion proposes a reasonable resolution of the COR EDIT issue based on this information from the IRS as reflected in the attached PLRs.

6. The adjustment to accumulated deferred income taxes due to the Tax Act for COR results in an EDIT asset of approximately $68 million to be recovered from customers. DEF's EDIT related to COR is amortized at the same rate as the protected EDIT, based on the Average Rate Assumption Method (ARAM), which is approximately 30 years, a much longer period than the 5-year period over which it would have been collected, pursuant to the 2017 Settlement Agreement, if treated as unprotected. Additionally, the 5-year period referenced in the 2017 Settlement Agreement was effectively 2018 - 2022 and will have expired by the time any PLR could be prepared, submitted, ruled upon and any accounting system modifications completed to identify the COR with sufficient specificity.

7. DEF's amortization of EDIT related to COR over the longer period is not a normalization violation. It also benefits customers by collecting funds owed to DEF over a longer period-of-time.

8. The Joint Movants agree that the intent of obtaining a PLR was to eliminate uncertainty around whether the normalization rules would require COR EDIT to be treated as either protected or unprotected, that uncertainty is eliminated through DEF's solution in a customer favorable manner, and therefore, obtaining a separate PLR is no longer required.

9. The amortization of both protected and unprotected EDIT has already been incorporated in the 2022-2024 revenue requirements in the 2021 Settlement. Accordingly, DEF's proposed treatment of the EDIT related to COR has no immediate impact on customer rates. By contrast, if DEF were to separately state the COR and treat it as unprotected (and thus subject to the shorter five-year recovery period), DEF would have to increase customer rates to account for this change. DEF and OPC agree that the best approach, given the unique circumstances presented here, is to continue the ARAM amortization and treat the EDIT related to COR as protected.

10. The Joint Movants agree that this Motion shall have no precedential value in any other proceeding.

11. The Joint Movants have conferred, pursuant to Rule 28-106.204(3), F.A.C., with the other parties in the docket, and are authorized to represent that FRF and PCS Phosphate do not object to this Motion, and FIPUG takes no position on this Motion.

12. The Joint Movants expressly consent to having the undersigned sign this Motion on their behalf.

WHEREFORE, the Joint Movants respectfully request that the Commission: (1) approve DEF's treatment of the EDIT associated with the COR as satisfying its requirements set forth in Order No. PSC-2019-0053-FOF-EI, and (2) close Docket No. 20180047-EI.

Respectfully submitted this 9th day of March, 2022.

/s/Dianne M. Triplett

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished via electronic mail to the following this 9th day of March, 2022.

/s/ Dianne M. Triplett
Attorney

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EXHIBIT A

Private Letter Rulings

Private Letter Ruling 202033002, 08/13/2020, IRC Sec(s). 168

UIL No. 168.24-01

Depreciation-accelerated cost recovery system-accumulated deferred federal income taxes-normalization rules-public utilities.

Headnote:

Regulated utility's depreciation related ADFIT balances created pursuant to normalization rules that were attributable to costs that were capitalized into basis of depreciable assets prior to taxpayer changing its method of accounting for those costs didn't remain subject to normalization rules after change in method of accounting pursuant to which such costs were reclassified as current deductions.

Reference(s): **Code Sec. 168;**

Full Text:

Number: **202033002**

Release Date: 8/14/2020

Index Number: 168.24-01

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact: [Redacted Text]

[Redacted Text], ID No.

Telephone Number: [Redacted Text]

Refer Reply To:

CC:PSI:B06

PLR-122510-19

Date:

March 26, 2020

In Re: [Redacted Text]

LEGEND:

Taxpayer =

Parent =

State A =

Commission A =

Commission B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Month 1 =

Month 2 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Year 6 =

Dear [Redacted Text]:

This letter responds to a request for a private letter ruling dated September 26, 2019, and submitted on behalf of Taxpayer regarding the application of the depreciation normalization rules under § 168(i)(9) of the Internal Revenue Code and § 1.167(l)-1 of the Income Tax Regulations (together, the "Normalization Rules") to certain State A state regulatory procedures which are described in this letter. The relevant facts as represented in your submission are set forth below.

FACTS

Taxpayer is an investor-owned regulated utility incorporated under the laws of State A. Taxpayer is an accrual basis taxpayer and reports on a calendar year basis.

Taxpayer is wholly owned by Parent. Parent is a State A corporation. Taxpayer is included in a consolidated federal income tax return of which Parent is the common parent.

Taxpayer is a regulated utility engaged principally in the purchase, transmission, distribution, and sale of electric energy and the purchase, distribution, and sale of natural gas in State A. Taxpayer is subject to regulation as to rates and conditions of service by Commission A as well as Commission B. Both these regulators establish Taxpayer's rates based on its costs, including a provision for a return on the capital employed by Taxpayer in its regulated businesses.

Taxpayer has claimed accelerated depreciation on all of its public utility property (both electric and gas) to the full extent those deductions have been available. Taxpayer has normalized the federal income taxes deferred as a result of its claiming these deductions in accordance with the Normalization Rules. As a consequence, Taxpayer has a substantial balance of accumulated deferred federal income taxes (ADFIT) that is attributable to accelerated depreciation reflected on its regulated books of account for each of its divisions. In accordance with State A ratemaking practice, Taxpayer has reduced its rate base by its ADFIT balance.

Commission B has established a system to track accounts for both jurisdictional electric and gas companies. These accounts prescribe the accounting rules which are used by most large investor-owned electric and gas companies and are employed by Taxpayer's electric and gas divisions. The applicable regulations contain several definitions relevant to Taxpayer's inquiry including definitions for cost of removal (COR), salvage value, net salvage value, service value, and depreciation.

In general, based on these definitions, for purposes of regulatory reporting, the net positive value or net cost of disposing of an asset at the end of its life is incorporated into the annual depreciation charge. COR is, therefore, most often (but not always) a component of establishing the applicable depreciation rate. In Taxpayer's case, due to the amount of COR it anticipates, in almost all instances its assets have negative net salvage values so that its book depreciation rate is higher than it would be were salvage value not considered. In effect, the annual depreciation charge creates a reserve for COR over the operating life of the asset. Since book depreciation expense is included in Taxpayer's cost of service used for establishing its rates, customers pay for the COR as book depreciation is factored into their rates. This COR reserve is reflected as an addition to Taxpayer's accumulated depreciation account. When the COR is actually incurred, the amount expended is debited to that same account, thereby reducing the balance.

For tax purposes, COR is deductible only when actually incurred. Taxpayer, therefore, reports its customer collections that fund the COR reserve as taxable income over the operating life of an asset, claiming an offsetting tax deduction only at the end of the life of that asset. Taxpayer has normalized COR since the Year 1 tax year. All references below to COR-related deferred tax accounting relate only to COR associated with assets placed in service after Year 2. Since COR is normalized in setting rates, customers are provided a tax benefit commensurate with their funding of COR. In other words, they are provided the COR tax benefit as they fund the COR reserve - prior to the time Taxpayer actually claims that benefit on its tax return.

The tax effect of the COR funding as described creates a deferred tax asset ("DTA"). This represents the future benefit to be derived from the eventual COR tax deduction. The COR-related DTA is included in Taxpayer's overall plant-related ADFIT account that reduces Taxpayer's ADFIT balance.

COR can (and does) impact ADFIT balances in an additional way. The COR included in depreciation expense (that is, the accrual) is an estimate prepared for an entire class of assets contained in a Commission B account. It is likely that any COR estimate will be too high or too low with respect to any individual asset with the ultimate answer remaining unknown until all vintages of each asset class are retired and removed. Any running variance from the estimate is recorded on Taxpayer's balance sheet. Where the accrual exceeds the actual COR, it creates a net credit to the accumulated depreciation account. Where the actual COR exceeds the accrual, it creates a net debit to that account. This treatment means that Taxpayer will recover under-accruals from customers and refund over-accruals to customers through future rate adjustments. These future rate adjustments will give rise to future increases or decreases in taxable income. Under applicable accounting principles, Taxpayer must record the deferred tax consequences of these future events. An over-accrual produces a DTA (the tax benefit of a future deduction due to the refund of the excess collection) while an under-accrual produces a deferred tax liability "DTL" (the tax cost of future taxable income due to the collection of the shortfall).

For the electric distribution division, the COR book/regulatory accrual has always been included in the development of the book depreciation rate. Thus, instead of waiting for the Taxpayer to incur the tax benefit of COR, its' Customers are provided the COR tax benefit as they fund the COR reserve - prior to the time Taxpayer actually claims that benefit on its tax return. This produces a DTA as described. In addition, as of Date 1, Taxpayer has, in total, incurred more COR than it has recovered from customers and, thus, is under-accrued for COR. This has produced a DTL, also as described. Both the DTA and DTL are included within Taxpayer's overall plant-related ADFIT Account.

Prior to Month 1 Year 3, the gas distribution division accrued and collected COR as a component of the book depreciation rate. However, pursuant to order of Commission A, that collection practice was modified in Year 3. Beginning in Month 1 Year 3, the gas-only COR regulatory accrual was removed from the book depreciation rate. Rather, Taxpayer was allowed to record and recover annually (through a fixed dollar depreciation charge incremental to the normal depreciation computed via application of the depreciation rate) an amount representing an estimate of the annual COR that would be incurred in that year. At the time of this modification, the cumulative COR accrued exceeded COR actually incurred (that is, Taxpayer was over-accrued). At that time, Taxpayer had recorded a net DTA (to reflect the tax benefit of the future reduction in rates associated with refunding the excess to customers).

Since converting to this methodology in Year 3, COR actually incurred has significantly exceeded COR accrued and recovered, resulting in a DTL (the tax cost of recovering the under-accrual in the future). As of Date 1, the two components (pre- Month 1 Year 3 and post-Month 2 Year 3) combined represented a net DTL.

Effective Date 2, pursuant to an Order issued by Commission A, gas COR regulatory recovery has reverted back to a component of the book depreciation rate. The fixed dollar accrual which began in Year 3 has been eliminated.

Since Year 4, Taxpayer's tax fixed asset system has separately identified the portion of Taxpayer's book depreciation expense that relates to COR since that date. As a consequence, the system distinguishes between COR book/tax differences and depreciation method/life differences even though they are both derived from Taxpayer's book depreciation. Though the system has the capability of tracking the reversals of these differences separately, in order to set it up to do this, a significant amount of work and data manipulation would be required. It is not currently configured in a manner that would allow this.

In years prior to Year 5, Taxpayer paid income tax at a 35% rate on the recovery of the COR portion of book depreciation (and provided its customers a tax benefit at that tax rate). However, as a result of the tax rate reduction enacted as part of the Tax Cuts and Jobs Act ("TCJA"), Taxpayer will only receive a 21% benefit when the COR deduction is claimed or when any over-accrual is refunded and will pay only a 21% tax on the recovery of any COR under-accrual. In other words, in the case of COR, the tax rate reduction enacted as part of the TCJA has produced both a deferred tax shortfall as well as an excess tax reserve. Because Taxpayer will not recover the 14% "excess" tax it paid on its recovery of the COR component of book depreciation from the government when it claims its COR deduction, it must recover it from its customers. Conversely, because Taxpayer will not pay the 14% "excess" deferred tax it accrued on its obligation to refund over-accrued COR, it must restore the amount to its customers (that is, it also has COR-related excess deferred taxes).

Taxpayer's Changes in Accounting Method for Mixed Service Costs and Repairs

Prior to Taxpayer's Year 6 tax year, in capitalizing its indirect overhead costs - including its mixed service costs - Taxpayer followed the same methodology for both book and tax purposes. Effective for its Year 6 tax year, Taxpayer filed with the Internal Revenue Service an Application for Change in Accounting Method (Form 3115) in which it requested permission to depart from its book method for tax purposes. The result of the change was to recharacterize a substantial quantity of mixed service costs that Taxpayer had previously capitalized into depreciable assets as deductible costs (including additions to cost of goods sold). This resulted in Taxpayer claiming a negative adjustment under § 481(a) (that is, a deduction) to remove from the tax basis of its existing assets all such recharacterized costs to the extent Taxpayer had not previously depreciated them (" Section 481 Adjustment").

Also, prior to Taxpayer's Year 6 tax year, in identifying deductible repairs, Taxpayer followed the same methodology for both book and tax purposes. Effective for its Year 6 tax year, Taxpayer filed an Application for Change in Accounting Method (Form 3115) in which it requested permission to depart from its book method for tax purposes. In general, under its new tax method, Taxpayer elected to use larger units of property than used for book purposes. The result of the change was to characterize many projects that were capitalized for book purposes as deductible repairs for tax purposes. This resulted in Taxpayer claiming a negative § 481 Adjustment to remove from the tax basis of its existing assets all such recharacterized costs to the extent Taxpayer had not previously depreciated them.

Adjustments (additions) were made to Taxpayer's ADFIT accounts, which already reflected the deferred tax consequences of having claimed accelerated depreciation on both types of costs after they were capitalized for tax purposes for the additional deferred taxes produced by the § 481 Adjustments.

Taxpayer's Recent Commission A Proceedings

On Date 3, Taxpayer filed with Commission A to adjust both its electric and its gas rates. The parties to the proceeding reached an agreement and, on or about Date 4, Taxpayer submitted a stipulation to Commission A for its approval. Commission A approved the stipulation on Date 5.

The stipulation provides that:

1) Taxpayer will seek a private letter ruling to determine if excess deferred taxes associated with excess tax over book depreciation that is subsequently reversed by accounting method changes relating to repair deductions and the capitalization of mixed service costs are protected by the normalization rules and subject to reversal under the ARAM; and that
2) Taxpayer will seek a private letter ruling from the IRS to determine whether post-Year 1 cost of removal is protected by the normalization rules and, if so, whether it is to be treated as a separate temporary difference or part of the overall depreciation temporary difference for purposes of ARAM amortization.

RULINGS REQUESTED

Taxpayer requests the following guidance:

1) Under the circumstances described above, is Taxpayer's electric distribution COR- related net DTL "protected" by the Normalization Rules?
2) If Taxpayer's electric distribution COR-related deferred tax is "protected," should that shortfall be treated as a discrete "protected" item or as part of the "protected" method/life difference?
3) Under the circumstances described above, is Taxpayer's gas distribution COR- related net DTA accumulated through the depreciation rate prior to Month 1 of Year 3 "protected" by the Normalization Rules?
4) If Taxpayer's gas distribution COR-related deferred tax accumulated through the depreciation rate prior to Month 1 of Year 3 is "protected," should that shortfall be treated as a discrete "protected" item or as part of the "protected" method/life difference?
5) Under the circumstances described above, is Taxpayer's gas distribution COR- related net DTL accumulated through the fixed estimated cash recovery after Month 1 of Year 3 "protected" by the Normalization Rules?
6) If Taxpayer's gas distribution COR-related net DTL accumulated through the fixed estimated cash recovery after Month 1 of Year 3 is "protected," should that shortfall be treated as a discrete "protected" item or as part of the "protected" method/life difference?
7) If Taxpayer's COR-related deferred tax shortfall is "protected," do the Normalization Rules permit Taxpayer to collect a shortfall any more rapidly than using the ARAM?
8) Do Taxpayer's depreciation-related ADFIT balances created pursuant to the Normalization Rules that are attributable to costs that were capitalized into the basis of depreciable assets prior to Taxpayer changing its method of accounting for those costs remain subject to the Normalization Rules after the change in method of accounting pursuant to which such costs were reclassified as current deductions?

LAW AND ANALYSIS

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

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.

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 481(a) requires those adjustments necessary to prevent amounts from being duplicated or omitted to be taken into account when a taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year. *See also* § 2.05(1) of Rev. Proc. 97-27, 97-27, 1997-1 C.B. 680 (the operative method change revenue procedure at the time Taxpayer filed its Form 3115, *Application for Change in Accounting Method*).

An adjustment under § 481(a) can include amounts attributable to taxable years that are closed by the period of limitation on assessment under § 6501(a). *Suzy's Zoo v. Commissioner*, 114 T.C. 1, 13 (2000), *aff'd*, 273 F.3d 875, 884 [88 AFTR 2d 2001-6916] (9th Cir. 2001); *Superior Coach of Florida, Inc. v. Commissioner*, 80 T.C. 895, 912 (1983), *Weiss v. Commissioner*, 395 F.2d 500 [22 AFTR 2d

5013] (10th Cir. 1968), *Spang Industries, Inc. v. United States*, 6 Cl. Ct. 38, 46 [54 AFTR 2d 84-5873] (1984), *rev'd on other grounds* 791 F.2d 906 [58 AFTR 2d 86-5052] (Fed. Cir. 1986). *See also Mulholland v. United States*, 28 Fed. Cl. 320, 334 [71 AFTR 2d 93-1916] (1993) (concluding that a court has the authority to review the taxpayer's threshold selection of a method of accounting *de novo*, and must determine, *ab initio*, whether the taxpayer's reported income is clearly reflected).

Sections 481(c) and 1.481-4 provide that the adjustment required by § 481(a) may be taken into accounting in determining taxable income in the manner, and subject to the conditions, agreed to by the Service and a taxpayer. Section 1.446-1(e)(3)(i) authorizes the Service to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e). *See also* § 5.02 of Rev. Proc. 97-27.

When there is a change in method of accounting to which § 481(a) is applied, § 2.05(1) of Rev. Proc. 97-27 provides that income for the taxable year preceding the year of change must be determined under the method of accounting that was then employed, and income for the year of change and the following taxable years must be determined under the new method of accounting as if the new method had always been used.

Because of their similarity, we address requests 1, 3, and 5 together. For all of the COR-related amounts at issue in these requests, the amounts are not protected by the Normalization Rules. Generally, § 168(i)(9)(A) does not refer to COR. Moreover, there is no reference to an acceleration of taxes but only to a deferral. While COR may be a component of the calculation of the amount treated as book depreciation, it is a deduction under § 162 and has nothing to do with actual accelerated tax depreciation. While depreciation method and life differences are created and reversed solely through depreciation, such is not the case with COR. While the COR timing differences may often originate as a component of book depreciation, it reverses through the incurred COR expenditure.

Taxpayer's ruling request 8 pertains to the depreciation-related ADIT existing prior to the year of change (Year 6) for public utility property in service as of the end of the taxable year immediately preceding the year of change. Beginning with the year of change, the Year 6 Consent Agreement granted Taxpayer permission to change its (1) method of accounting for mixed service costs to recharacterize a substantial quantity of mixed service costs that Taxpayer had previously capitalized into depreciable assets as deductible costs (including additions to cost of goods sold) and (2) to depart from its book method for tax purposes electing to use for tax purposes larger units of property than used for book purposes which resulted in characterizing many projects that were capitalized for book purposes as deductible repairs for tax purposes.

When there is a change in method of accounting to which § 481(a) is applied, income for the taxable year preceding the year of change must be determined under the method of accounting that was then employed by Taxpayer, and income for the year of change and the following taxable years must be determined under Taxpayer's new method of accounting as if the new method had always been used. *See* § 481(a); § 1.481-1(a)(1); and § 2.05(1) of Rev. Proc. 97-27. In other words:

(1) Taxpayer's new method of accounting is implemented beginning in the year of change; (2) Taxpayer's old method of accounting used in the taxable years preceding the year of change is not disturbed; and (3) Taxpayer takes into account a § 481(a) adjustment in computing taxable income to offset any consequent omissions or duplications.

Accordingly, for public utility property in service as of the end of the taxable year immediately preceding the year of change (Year 6), the depreciation-related ADIT existing prior to the year of change for the changes in methods of accounting subject to the Year 6 Consent Agreement does not remain subject to the normalization method of accounting within the meaning of § 168(i)(9) after implementation of the new tax methods of accounting in the year of change and subsequent taxable years.

Based on the foregoing, we conclude that:

1) Under the circumstances described above, Taxpayer's electric distribution COR- related net DTL is not "protected" by the Normalization Rules.
3) Under the circumstances described above, Taxpayer's gas distribution COR-related net DTA accumulated through the depreciation rate prior to Month 1 of Year 3 is not "protected" by the Normalization Rules.
5) Under the circumstances described above, Taxpayer's gas distribution COR-related net DTL accumulated through the fixed estimated cash recovery after Month 1 of Year 3 is not "protected" by the Normalization Rules.

Because these amounts in requests 1, 3, and 5 are not protected by the Normalization Rules, requests 2, 4, 6, and 7 are moot.

8) Taxpayer's depreciation related ADFIT balances created pursuant to the Normalization Rules that are attributable to costs that were capitalized into the basis of depreciable assets prior to Taxpayer changing its method of accounting for those costs do not remain subject to the Normalization Rules after the change in method of accounting pursuant to which such costs were reclassified as current deductions.

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

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

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

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

Sincerely,

Patrick S. Kirwan

Chief, Branch 6

Office of Associate Chief Counsel

(Passthroughs & Special Industries)

cc: [Redacted Text]

Private Letter Rulings

Private Letter Ruling 202124003, 06/18/2021, IRC Sec(s). 168

UIL No. 168.24-01

Depreciation-accelerated cost recovery system-accumulated deferred federal income taxes-normalization rules-public utilities.

Headnote:

Regulated utility's depreciation related ADFIT balances created pursuant to normalization rules that were attributable to cost of removal-related shortfall weren't protected under normalization rules.

Reference(s): **Code Sec. 168;**

Full Text:

Number: **202124003**

Release Date: 6/18/2021

Index Number: 168.24-01

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact: [Redacted Text]

[Redacted Text] , ID No.

Telephone Number: [Redacted Text]

Refer Reply To:

CC:PSI:B06

PLR-120934-20

Date:

March 22, 2021

In Re: [Redacted Text]

LEGEND:

Taxpayer =

Parent =

Commission A =

Commission B =

State A =

State B =

Electric Division =

Gas Division =

Date 1 =

Year A =

Year B =

Director =

Dear [Redacted Text]

This letter responds to a request for a private letter ruling dated September 24, 2020, and submitted on behalf of Taxpayer regarding the application of the depreciation normalization rules under § 168(i)(9) of the Internal Revenue Code (the Code) and § 1.167(l)-1 of the Income Tax Regulations (together, the "Normalization Rules") to certain State A state regulatory procedures which are described in this letter. The relevant facts as represented in your submission are set forth below.

FACTS

Taxpayer is an investor-owned "combination" regulated utility that is incorporated and operates in State A. It is an indirect, wholly-owned subsidiary of Parent, a State B corporation. Taxpayer is included on the consolidated federal income tax return of Parent. Through its Electric Division, Taxpayer is engaged in the business of generation, purchase, transmission, distribution and sale of electric energy. Through its Gas Division, Taxpayer is engaged in the purchase, distribution, and sale of natural gas. Taxpayer employs the accrual method of accounting and reports on the calendar year basis. Both Divisions of Taxpayer are subject to regulation by Commission A. Rates for both divisions are set on a "rate of return" basis.

Taxpayer has claimed accelerated depreciation on its public utility properties to the full extent allowed by the Code. Taxpayer has normalized the federal income taxes deferred in accordance with the Normalization Rules. Consequently, Taxpayer has a substantial balance of Accumulated Deferred Federal Income Taxes "ADFIT" attributable to accelerated depreciation reflected on its regulated books of account for both divisions. In accordance with ratemaking practices under Commission A, Taxpayer has included its ADFIT balance in its capital structure as cost-free capital.

Commission B has, by regulation, established Uniform Systems of Accounts "USOAs" which are applicable to both divisions of Taxpayer. The USOAs contain several definitions relevant to Taxpayer's request. Specifically, the USOAs define cost of removal "COR" as:

> ... the cost of demolishing, dismantling, tearing down or otherwise removing electric plant, including the cost of transportation and handling incidental thereto.

"salvage value" as:

> ... the amount received for property retired, less any expenses incurred in connection with the sale or in preparing the property for sale.

"net salvage value" as:

> ... the salvage of property retired less the cost of removal. "service value" as: ... the difference between original cost and net salvage value of electric plant.

and "depreciation" as:

> ... the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of electric plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance.

Therefore, for the purposes of regulatory reporting, the net positive value or net cost of disposing of an asset at the end of its life is incorporated into the annual depreciation charge. COR is, therefore, a component of establishing the applicable depreciation rate. Both Divisions of Taxpayer break out the COR and salvage rates separately from depreciation. The net rate is considered the Life Rate that is approved by Commission A. The COR and salvage reserves are tracked separately from accumulated depreciation in Taxpayer's continuing property records.

Since depreciation expense is included in Taxpayer's cost of service used for establishing its rates, customers pay for the COR as book depreciation in their rates. However, for tax purposes, COR is deductible only when actually incurred. Therefore, for tax purposes, Taxpayer reports its customer collections that fund the COR reserve as taxable income over the operating life of an asset, claiming an offsetting tax deduction only at the end of the life of that asset. Since COR is normalized in setting rates, customers are provided a tax benefit commensurate with their funding of COR.

Accounting Standards Codification "ASC" 98-740-25-2, which is followed by the Taxpayer, provides that if, as a result of an action by a regulator, it is probable that the future increase or decrease in taxes would be recovered from or returned to customers through future rates, an asset or liability shall be recognized for that probable future revenue or reduction in future revenue. Moreover, that asset or liability also shall be a temporary difference for which a deferred tax liability (DTL) or asset shall be recognized.

The tax effect of recovering COR through rates before the associated tax deduction can be claimed creates a deferred tax asset (DTA). This represents the future benefit to be derived from the eventual COR tax deduction.

Since Year A, Taxpayer has been able to separately identify the portion of its accumulated book depreciation reserve that relates to the COR accrual balance. Consequently, Taxpayer distinguishes between COR book/tax differences and depreciation method/life differences even though they are both derived from Taxpayer's book depreciation rates and expense. Taxpayer's system can, therefore, track the reversals of these differences separately.

Taxpayer's Recent Commission A Proceedings

On Date 1, Commission A opened two dockets for Taxpayer for the purpose of identifying and quantifying the potential impact of the TCJA on both Divisions of Taxpayer tax-related costs and to determining a method of incorporating that impact into their respective rates. Among the impacts considered was quantification of the deferred federal income taxes previously provided that, as a result of the tax rate reduction enacted by the TCJA, are no longer necessary to fund the reversal of prior timing differences (Excess Deferred Federal Income Taxes "EDFIT"). As a component of this amount, Taxpayer calculated its Excess Tax Reserve "ETR" as defined in Section 13001(d) of the TCJA. Taxpayer also quantified the effect of applying the Average Rate Assumption Method "ARAM" to that reserve. Since, by statute, the ETR consists only of ADFIT required to be provided under the Normalization Rules, the ARAM is only mandatorily applicable to such ADFIT.

One of the issues Taxpayer had to consider in computing its ETR in each of the dockets was whether or not the ADFIT shortfall created by COR is "protected". Taxpayer concluded that COR is not subject to the Normalization Rules because it is not a depreciation life/method difference. It, therefore, treated the COR-related ADFIT shortfall as unprotected in each of the two dockets. Consistent with this view, Taxpayer believes that the recovery of the COR-related ADFIT shortfall from customers is not constrained by the Normalization Rules.

RULINGS REQUESTED

Taxpayer requests the following guidance:

1) Under the circumstances described above, is Taxpayer's COR-related deferred tax shortfall "protected" by the Normalization Rules?
2) If Taxpayer's COR-related deferred tax shortfall is "protected," should that shortfall be treated as a discrete "protected" item or as part of the "protected" method/life difference?
3) If Taxpayer's COR-related deferred tax shortfall is "protected," do the Normalization Rules permit Taxpayer to collect that shortfall any more rapidly than using the ARAM?

LAW AND ANALYSIS

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

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.

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.

For the COR-related amounts at issue in this request, the amounts are not protected by the Normalization Rules. Generally, § 168(i)(9)(A) does not refer to COR. Moreover, there is no reference to an acceleration of taxes but only to a deferral. While COR may be a component of the calculation of the amount treated as book depreciation, it is a deduction under § 162 and has nothing to do with actual accelerated tax depreciation. While depreciation method and life differences are created and reversed solely through depreciation, such is not the case with COR. While the COR timing differences may often originate as a component of book depreciation, it reverses through the incurred COR expenditure. Prior to Year B, Taxpayer paid income tax at a rate of 35% rate on the receipt of the COR portion of book depreciation (and provided its customers a tax benefit at that rate) from its customers. However, as a result of the tax rate reduction enacted as part of the TCJA, Taxpayer will receive a 21% benefit when the COR deduction is actually claimed. Thus, the situation is precisely the opposite from that of method/life differences where accelerated deductions produced a 35% tax benefit but, when reversed, will become subject to only a 21% income tax. Thus, in the case of COR, the tax rate reduction enacted as part of the TCJA produced a deferred tax shortfall, not an excess deferred tax reserve. Because Taxpayer will not recover the 14% "excess" tax it paid on its recovery of the COR component of book depreciation from the government when it claims its COR deduction, it may recover this amount from its customers consistent with the Normalization rules.

Based on the foregoing, we conclude that:

1) Under the circumstances described above, Taxpayer's COR-related net DTA is not "protected" by the Normalization Rules.

Because the amounts in request 1 are not protected by the Normalization Rules, requests 2 and 3 are moot.

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

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

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

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

Sincerely,

Patrick S. Kirwan

Chief, Branch 6

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