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Charles A. Guyton
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February 11, 1991

Commissioner Thomas M. Beard
Commissioner J. Terry Deason
Commissioner Betty Easley
Commissioner Gerald L. Gunter
Commissioner Michael Wilson
Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32399

RE: Refund of Unamortized Oil Backout ITC
[redacted]

Dear Commissioners:

Pursuant to Order Nos. 22268 and 23289 in Docket No. 890148-EI, Florida Power & Light Company ("FPL") is filing its Letter Ruling from the Internal Revenue Service ("IRS" or "Service") regarding whether the rapid flow back of unamortized investment tax credits associated with FPL's oil backout project would violate the Internal Revenue Code. In its Letter Ruling the Service has determined that the refund resulting from the rapid flow back of the investment tax credits associated with FPL's oil backout project is permissible.

In Order No. 23289, the order approving FPL's draft ruling request, the Commission ordered FPL to make a refund upon a favorable ruling from the IRS. FPL proposes the following means of implementing a refund. FPL proposes to refund to customers on an equal cents per kwh basis, over the April through September 1991 period, the revenue effect of the unamortized balance of investment tax credit which FPL has computed in its most recent oil backout filing would remain as of October 1, 1991. The revenue effect of the projected unamortized balance, plus accrued interest through the refund period, would be shown as a separate line item on each customer's bill. Any over or under refund would be adjusted on FPL books in October 1991 and recognized in a subsequent oil backout true up.

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This proposal has several advantages. First, as noted in FPL's 1988 tax savings refund order, a six month refund avoids seasonal inequities. Second, it effectuates the refund without disrupting the current fuel and oil backout proceeding. Third, it apprises customers of the refund rather than treating it as a credit in the fuel factor. Fourth, it requires no further adjustment to oil backout investment tax credits amortization.

As of March 31, 1991, the unamortized balance of oil backout project investment tax credits will be $16,389,703. Under FPL's proposal $439,056 will be flowed back through the Oil Backout Cost Recovery Factor during April through September 1991 as part of regular amortization. The jurisdictional revenue effect of the remaining $15,950,647 of unamortized project investment tax credits ($25,667,068), plus accrued interest from April 1990 through September 1991 ($2,743,910), would be refunded through a cents per kwh factor during the April through September period. This will result in a total refund of $28,410,978.

Since the proposed refund would begin on April 1, it would be helpful to all parties for the Commission to consider this proposal expeditously. FPL respectfully requests that this matter be processed to allow Commission action at its March 5th Agenda Conference.

Respectfully submitted,

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Attorneys for Florida Power
& Light Company

By: Charles A. Guyton
Charles A. Guyton

cc: Steve Tribble
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Internal Revenue Service

Department of the Treasury

PO Box 7604
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Washington, DC 20044

Person to Contact:

Telephone Number:

Refer Reply to:
CC:P&SI:6 TR-31-2202-90

Index No. 0046.06-06

Date: JAN 30 1991

Re: Ruling Request -

Legend

Commission =
Order =
Rule =
Project =
Date 1 =
Date 2 =
Date 3 =

Dear

This is in response to your request for a letter ruling, dated July 23, 1990, regarding the Federal income tax consequences of the Order issued by the Commission. In summary, that Order requires a change in the flow back of unamortized investment tax credits associated with the Project, the costs of which have been fully recovered through state statute and application of the regulatory Rule. In your letter, you stated that your company is uncertain as to whether the Order complies with the requirements of section 46(f) of the Internal Revenue Code and section 1.46-6 of the Income Tax Regulations.

The relevant facts included in your submission follow. Your company is an investor-owned public utility engaged in the operation of an integrated electric utility system involving the generation, transmission, distribution, and sale of electrical energy. Your company has made a timely election under section 46(f)(2) of the Code to use the ratable flow-through method of accounting and ratemaking for the investment tax credit. Your company has fully normalized all book-tax timing differences, for the investment tax credit. Your company has fully normalized all book-tax differences, including depreciation since 1976.

The Commission adopted the Rule which was intended to allow for timely recovery of the cost of implementing certain types of conservation projects. All costs subject to the Rule are to be recovered by the use of a factor that includes straight-line depreciation expense over the useful life of the project, capital costs, actual tax expense and operating and maintenance expenses. The rule also allows additional amounts to be recovered in rates

and recorded on the regulatory books of account as additional book expense in an amount equal to two-thirds of the actual net savings, if any, associated with a project. All costs associated with a project subject to the Rule are segregated and accounted for separately. The revenue requirements of a project subject to the Rule are determined on the basis of the project's own independent capital structure, capital investment and expenses.

The Commission granted approval for your company to recover the cost of the Project through the factor developed by application of the Rule. The primary purpose of the Project was to reduce dependency on oil while assuring adequate service at a reasonable cost to the ratepayers.

Beginning on Date 1, all related costs of Phase 1 of the Project (book depreciation expense computed using the straight-line method, a rate of return on the unrecovered capital costs of the Project and associated income taxes) were recovered through the mechanism provided by the Rule. The accounting treatment of the assets and expenses associated with the Project has been separately maintained. Recovery of the costs associated with the Project was through the fuel adjustment clause, an additional line item on the customers' bills, and not through base rates. The cost recovery mechanism for the Project does not establish base rates and is, therefore, not a conventional ratemaking method.

Phases 2 and 3 of the Project were placed in service for tax and book purposes in subsequent years and the entire Project was completed on Date 2. A net savings was achieved by the Project beginning on Date 3. As a result, the factor was increased under operation of the Rule to reflect two-thirds of the net savings. The increase in the factor was recorded on the books as additional book depreciation expense resulting in your company fully recovering the Project's depreciable capital costs within a 2-year period instead of the longer, previously established book life.

Your letter states that all parties agree that the additional book depreciation has been treated in the same manner as the straight line book depreciation for deferred taxes, cost of service, and the collection of the revenue requirements. The sum of the straight line and additional book depreciation was the depreciation expense use by the Commission for purposes of establishing your company's cost of service for calculating the revenue requirements related to the Project and for establishing rates charged to customers. Seven years was the period of time actually used by your company in computing its regulated depreciation expense for the Project property. Both the straight-line and additional Project book depreciation were used to calculate tax deferrals.

Since the time the Project was placed in service, including the period additional book depreciation was being recovered, your company has amortized the investment tax credit generated by the Project at a composite book life for all utility property, including Project property, qualifying for the investment tax credit without consideration of the additional capital recovered through Project book depreciation. The composite investment tax credit amortization rate is calculated by dividing book depreciation expense, without the additional Project book depreciation expense, for the year-end plant balance including Project property. Under your company's investment tax credit amortization method, the flow-back at the unamortized investment tax credit associated with Project property will be over the next 17 to 20 years, depending on the date the associated property was placed in service. During that period of time, a return will be earned on only the non-depreciable Project property.

Contingent on this letter ruling, the Commission has ordered your company to flow-back the unamortized investment tax credits associated with the Project over a six-month period. The order will not affect the return to be earned by unamortized investment tax credit balances not related to the Project nor will it affect the period of time over which those other credits are amortized. You have asked us to rule whether a final determination by the Commission that orders your company to flow-back in rates the unamortized investment tax credit associated with the Project, the depreciable capital costs of which have been fully recovered through rates, would violate the requirements of section 46(f)(2) of the Code.

Section 46(f)(2) of the Code, which the Company has elected, provides the special rule for ratable flow-though of the investment tax credit claimed on public utility property as follows:

> "SPECIAL RULE FOR RATABLE FLOW-THROUGH. - If the taxpayer makes an election under this paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary, paragraph (1) shall not apply, but no credit determined under subsection (a) shall be allowed by section 38 with respect to any property described in section 50 (as in effect before its repeal by the Revenue Act of 1978) which is public utility property (as defined in paragraph (5)) of the taxpayer --
> (A) COST OF SERVICE REDUCTION. --

> If the tax- payer's cost of service for ratemaking purposes or in its regulated books of account is reduced by more than a ratable portion of the credit determined under subsection (a) and allowable by section 38 (determined without regard to this subsection), or(B) RATE BASE REDUCTION. -- If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit determined under subsection (a) and allowable by section 38 (determined without regard to this subsection)."

Code section 46 (f)(6) provides as follows:

> "RATABLE PORTION. For purposes of determining ratable restorations to base under paragraph (1) and for purposes of determining ratable portions under paragraph (2)(A), the period of time used in computing depreciation expense for purposes of reflecting operating results in the taxpayer's regulated books of account shall be used."

Code section 46 (f)(5) provides, in part, that:

> PUBLIC UTILITY PROPERTY. For purposes of this subsection, the term 'public utility property' means - (A) property which is public utility property within the meaning of subsection (c)(3)(B)..."

Code section 46 (c)(3)(B) provides, in part, as follows:

> "For purposes of subparagraph (A), the term 'public utility property' means property used predominantly in the trade or business of the furnishing or sale of
>
> (i) electrical energy, water, or sewage disposal services, ***
>
> if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United

States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

Regulations section 1.46-6(g) provides, in part, as follows:

"Ratable methods. (1) In general. Under this paragraph (g), rules are prescribed for purposes of determination whether or not, under section 46(f)(1), a reduction in the taxpayer's rate base with respect to the credit is restored less rapidly than ratably and whether or not under section 46(f)(2) the taxpayer's cost of service for ratemaking purposes is reduced by more than a ratable portion of such credit.

(2) Regulated depreciation expense. What is `ratable' is determined by considering the period of time actually used in computing the taxpayer's regulated depreciation expense for the property for which a credit is allowed. `Regulated depreciation expense' is the depreciation expense for the property for which a credit is allowed. `Regulated depreciation expense' is the depreciation expense for the property used by a regulatory body for purposes of establishing the taxpayer's cost of service for ratemaking purposes. Such period of time shall be expressed in units of years (or shorter periods), units of production, or machine hours and shall be determined in accordance with the individual useful life system or composite (or other group asset) account system actually used in computing the taxpayer's regulated depreciation expense. A method of restoring, or reducing, is ratable if the amount to be restored to rate base, or to reduce cost of service (as the case may be), is allocated ratably in proportion to the number of such units. Thus, for example, assume that the regulated depreciation expense is computed under the straight line method

> by applying a composite annual percentage rate to 'original cost' (as defined for purposes of computing regulated depreciation expense). If, with respect to an item of section 46(f) property, the amount to be restored annually to rate base is computed by applying a composite annual percentage rate to the amount by which the rate base was reduced, then the restoration is ratable. Similarly, if cost of service is reduced annually by an amount computed by applying a composite annual percentage rate to the amount of the credit, cost of service is reduced by a ratable portion. If such composite annual percentage rate were revised for purposes of computing regulated depreciation expense beginning with a particular accounting period, the computation of ratable restoration or ratable portion (as the case may be) must also be revised beginning with such period. A composite annual percentage rate is determined solely by reference to the period of time actually used by the taxpayer in computing its regulated depreciation expense without reduction for salvage or other items such as over and under accruals."

From the facts set out above we conclude that under the Order the flowback of the unamortized investment tax credits would not violate the requirements of section 46 (f)(2) of the Code. Under section 46 (f)(2), no investment tax credit on the Project will be allowable if your company's cost of service is reduced by more than a ratable portion of the investment tax credit. According to section 46 (f)(6), in determining what is ratable under section 46 (f)(2), one must refer to the period of time used in computing ratemaking depreciation expense. Finally, section 1.46-6 (g)(2) of the regulations requires a revision of the ratable restoration period when the composite annual percentage rate used for purposes of computing regulated depreciation expense is revised.

In this case, the Commission through application of the use and adjustment of the factor under the Rule had shortened the regulatory depreciation period with the additional depreciation expense. Section 46 (f)(2) of the Code is violated when the cost of service is reduced more rapidly than ratably. There is no violation where flow-through is less rapid that ratable, or where

there is flow-through in any amount after lapse of the regulatory depreciation period. The requirement of section 1.46-6(g)(2) of the regulations ensures that there will not be a violation where there is an adjustment of composite annual percentage rate, by providing for a corresponding adjustment of the computation of ratable restoration. However, failure to adjust does not in itself violate section 46 (f)(2). The reduction of cost of service must be more rapid than ratable and here the flow-through is either less than ratable or occurs after the lapse of the regulatory depreciation period. Thus, the requirements of section 46 are not violated.

A copy of this letter should be filed with the Taxpayer's income tax return for the taxable year in which the transaction covered by this ruling is consummated.

This ruling is directed only to the taxpayer who requested it. Section 6110 (j)(3) of the Code provides that it may not be used or cited as precedent. Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore this ruling will be modified or revoked by adoption of temporary or final regulations, to the extent the regulations are inconsistent with any conclusion in the ruling. See section 11.04 of Rev. Proc. 91-1, 1990-1 I.R.B. 9. However, when the criteria in section 11.05 of Rev. Proc. 91-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Pursuant to a power of attorney on file with this office, copies of this letter have been sent to your designated authorized representatives.

Sincerely yours,

(signed)
Charles B. Ramsey

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

Enclosures: (2)
copy of this letter
copy of section 6110 purposes

Department of the Treasury
Internal Revenue Service

OMB No. 1545-0633
Expires: 2-28-93

Notice of Intention to Disclose

Date of Mailing of This Notice	FEBRUARY	1	1991
Last Date to Request Service Review	FEBRUARY	21	1991
Last Date to Request Delay	APRIL	2	1991
Last Date to Petition Tax Court	APRIL	2	1991
Date Open to Public Inspection	APRIL	26	1991

Section 6110 of the Internal Revenue Code provides that copies of certain rulings, technical advice memoranda, and determination letters will be open to public inspection after deletions are made. Rulings and technical advice memoranda will be open to public inspection in the National Office Reading Room, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, where they may be read and copied by anyone interested.

In accordance with section 6110, we intend to make open to public inspection the enclosed deleted copy of your ruling. The deletions indicated were made in accordance with section 6110(c), which requires that the following be deleted:

1. the names, addresses, and other identifying details of the person to whom the ruling pertains and of any other person identified in the ruling (other than a person making a "third party communication"—see back of this notice);
2. information specifically authorized under criteria established by an Executive Order to be kept secret in the interest of national defense or foreign policy, and which is in fact properly classified pursuant to such Executive Order;
3. information specifically exempted from disclosure by any statute (other than the Internal Revenue Code) which is applicable to the Internal Revenue Service;
4. trade secrets and commercial or financial information obtained from a person and privileged or confidential;
5. information the disclosure of which would constitute a clearly unwarranted invasion of personal privacy;
6. information contained in or related to examination, operating, or condition reports prepared by, or on behalf of, or for use of an agency responsible for the regulation or supervision of financial institutions; and
7. geological and geophysical information and data, including maps, concerning wells.

These are the only grounds for deletion of material. The indicated proposed deletions were made after consideration of any suggestions for deletions you may have made prior to issuance of the ruling.

If You Agree with the proposed deletions, you need not take any further action and we will place the deleted copy in the National Office Reading Room on the "Date Open to Public Inspection" shown on this notice.

If You Disagree with the proposed deletions, please return the deleted copy and indicate, in brackets, any additional information you believe should be deleted. Include a statement supporting your position. Only material falling within the seven categories listed above may be deleted; accordingly, your statement should specify which of these seven categories is applicable with respect to each additional deletion you propose. Your submission should be addressed to:

Commissioner of Internal Revenue
Attention: CC:CORP:T
Ben Franklin Station
Post Office Box 7604
Washington, D.C. 20044

It must be postmarked no later than the "Last Date to Request Service Review" shown on this notice. Your submission will be given careful consideration. If we feel we cannot make any or all of the additional deletions you suggest, we will so advise you no later than 20 days after receipt of your submission. You will then have the right to file a petition in the United States Tax Court if you disagree with us. Your petition must be filed no later than the "Last Date to Petition Tax Court" shown on this notice, which is 60 days after the date of mailing of this notice. If a petition is filed in the Tax Court, the disputed portion(s) of the ruling will not be placed in the Reading Room until after a court decision becomes final.

If no petition is filed in the Tax Court, the deleted copy of your ruling will be made open to public inspection within 75 to 90 days after the date of mailing of this notice. If the transaction to which the ruling relates will not be completed by then, a request for delay of public inspection may be made.