414 Nicollet Mall
Minneapolis, MN 55401

September 29, 2016

—Via Electronic Filing—

Mr. Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, MN 55101

RE: RESPONSE COMMENTS
TRANSMISSION COST RECOVERY RIDER
DOCKET NO. E002/M-15-891

Dear Mr. Wolf:

Northern States Power Company, doing business as Xcel Energy, submits the enclosed Comments in response to the September 7, 2016 Response Comments of the Department of Commerce, Division of Energy Resources in the above-referenced docket.

Pursuant to Minn. Stat. § 216.17, subd. 3, we have electronically filed this document, and served copies on the parties on the attached service list.

If you have any questions regarding this filing please contact me at (612) 330-6064 or bria.e.shea@xcelenergy.com.

Sincerely,

/s/

BRIA E. SHEA
REGULATORY MANAGER

Enclosures
c: Service List

STATE OF MINNESOTA
BEFORE THE
MINNESOTA PUBLIC UTILITIES COMMISSION

Beverly Jones Heydinger	Chair
Nancy Lange	Commissioner
Dan Lipschultz	Commissioner
Matthew Schuerger	Commissioner
John Tuma	Commissioner

IN THE MATTER OF THE PETITION OF NORTHERN STATES POWER COMPANY FOR APPROVAL OF A MODIFICATION TO ITS TCR TARIFF, 2016 TCR RATE FACTORS, AND 2015 TCR TRUE-UP AND COMPLIANCE FILING	DOCKET NO. E002/M-15-891 **RESPONSE COMMENTS**

OVERVIEW

Northern States Power Company, doing business as Xcel Energy, submits this response to the September 7, 2016 Response Comments of the Minnesota Department of Commerce, Division of Energy Resources regarding our Petition seeking approval of a Transmission Cost Recovery (TCR) Rider rate factor for 2016. We appreciate the Department's thorough review and recommendation to approve recovery of the costs associated with all transmission projects included in our request.

A. IRS Regulations Require Proration

In addition, the Department also recommended that (1) Accumulated Deferred Income Taxes (ADIT) proration is not required, and further that (2) ADIT proration at true-up is not required. With regards to the first matter, we note that all utilities are required to follow IRS regulations, and the regulations *clearly* and *without question* state that ADIT proration is required. There is not any uncertainty on this topic in the industry.

However, while the Company must prorate its ADIT balances, we understand there is some level of inconsistency in the industry regarding treatment of the ADIT true-up. The Company's understanding of the IRS regulations is that the true-up balances

also must be prorated, whereas the Department asserts that the true-up should not be prorated.[1]

B. Decision on Treatment of True-Up should be Deferred

While we disagree with the Department's recommendations regarding the treatment of ADIT proration at true-up, we do not believe a decision is necessary on the issue at this time. With this in mind, we respectfully request the Commission confirm ADIT proration is appropriate and defer a decision on the treatment of true-up calculations to a future proceeding. Since there is still some uncertainty on the issue, deferral would allow additional development of the subject including potential guidance from the IRS, the FERC, and Commission proceedings.[2]

Should the Commission decide a resolution is necessary at this time, we note that if either of the Department's recommendations related to ADIT proration are adopted, the Company would be in violation of IRS guidelines. Not only would we be required to notify the IRS of a violation but this would ultimately harm our customers because they would no longer be able to experience the lower rates that come from beneficial tax depreciation treatment.

In our view, here are three of the Commission's options (in order of Xcel Energy's preference) as well as the associated outcomes of those options:

1. Approve our TCR Rider rate factor for 2016, confirm ADIT proration is required, and defer proration of ADIT at true-up decision to a later proceeding.
    a. This TCR proceeding does not include a true-up of the ADIT balance, and thus our 2016 revenue requirements can be approved as proposed even if the Commission defers a decision on the treatment of the true-up balance. If additional guidance from the IRS, the FERC, or other proceedings shows our ADIT proration treatment to be unsupported, we would credit to customers any difference through the TCR tracker.
2. Defer the entire ADIT proration decision as well as our TCR Rider rate factors for 2016.
    a. If the Commission takes this action, the Company would continue to collect at the current TCR rate factors without adjustment.
3. Order the Company to not prorate ADIT in general or at true-up as the Department has suggested.

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[1] See the Direct Testimony of Ms. Nancy Campbell in Docket No. E002/GR-15-826.

[2] For example, the ALJ Report on Otter Tail Power's (OTP) rate case (Docket No. E017/GR-15-1033) is expected by January 5, 2017.

a. If the Commission takes either of these actions, the Company would be required to notify the IRS of the Commission's Order that results in the Company being in violation of Tax Normalization Rules.

While the Company recommends the Commission defer a decision at this time, we further clarify our position on ADIT proration treatment in the below Response Comments. We provide:

- Background on accelerated depreciation and Tax Normalization Rules;
- Support for why ADIT proration is necessary;
- Support for why Private Letter Rulings (PLRs) can and should be used as guidance;
- Recent IRS guidance that supports the proration methodology;
- Support for why maintaining proration in the true-up to actuals is required;
- Recent FERC decisions that support proration of the true-up balance;
- An explanation for why the current FERC tariffs do not include the proration method;
- A discussion of why the use of an historic test year is not the appropriate solution to address ADIT; and
- An explanation of the harm to customers should the Commission accept the Department's recommendation that the Company not be allowed to prorate ADIT.

RESPONSE

The Department recommends that the Commission not allow the Company to use any prorated ADIT balances or, in the alternative, require our TCR Rider to be based solely on historical costs. Below we provide a background on accelerated depreciation and Normalization rules and then support why ADIT proration is required, why the proration of the ADIT true-up is required, and the customer harm that will come if the Department's recommendation is adopted.

A. Background on Accelerated Depreciation and Normalization Rules

Accelerated depreciation refers to the depreciation method used for income tax purposes. This method accelerates tax depreciation in the early years of an asset's life, faster than the use of the straight line depreciation method. In contrast to accelerated depreciation, straight line depreciation recovers the cost of an asset in equal amounts each year over the asset's expected productive life. The difference

between the income taxes based on straight-line book depreciation and accelerated tax depreciation are reflected as ADIT.[3]

The ADIT deferral is a significant tax incentive that Congress adopted with the specific intent of encouraging businesses to make capital investments. In public utility rate cases, many regulatory agencies, including this Commission, consider the related accumulated deferred income tax liabilities to be cost-free capital available to the utility and, consequently, require that they be credited to rate base for ratemaking purposes.

ADIT provides the Company access to cost-free capital it would not otherwise have. ADIT is subtracted from rate base, thus reducing the financing costs included in the revenue requirement. Annual deferred tax expense is part of the revenue requirement, and there is an equal and offsetting decrease to current tax expense. Thus, all customers benefit from the tax deduction of the asset cost ratably over its useful life.

In fact, Congress has imposed specific requirements and restrictions on a utility's ability to use accelerated and bonus depreciation. Congress (and the IRS acting under Congressional authority and direction) has established specific preconditions for a utility to use accelerated and bonus depreciation for federal income tax purposes, which are called the Tax Normalization Rules.

Tax Normalization Rules encompass requirements from the Internal Revenue Code (IRC), Treasury Regulations and related guidance provided by the IRS, such as PLRs. Specifically, Tax Normalization Rules are set forth in IRC § 168(f)(2) and § 168(i)(9), provided as Attachment A. These rules require that deferred taxes created based on accelerated tax methods cannot flow back any faster than straight line depreciation would provide for over book life. The associated regulations further define how the deferred tax balance for the federal portion of Federal Energy Regulatory Commission (FERC) Account 282 must be calculated for the future test year. (See Treasury Regulations Section 1.167(l)-1(h)(6)).

Congress did not directly prohibit regulators from using other methods to set rates; however, the consequences of a regulator doing so is the utility's loss of accelerated depreciation, including bonus depreciation, for federal income tax purposes. In light

[3] There are four categories of ADIT recognized in the Uniform System of Accounts in four separate accounts; however, only three of these categories of ADIT are related to accelerated depreciation for plant assets included in rate base, including bonus depreciation: Accounts 190, Accumulated Deferred Income Taxes; 281, Accumulated Deferred Income Taxes-Accelerated Amortization Property; and 282, Accumulated Deferred Income Taxes-Other Property.

of the potential loss of accelerated deductions and for other reasons, Minnesota and virtually all other jurisdictions have adopted the normalization method of tax accounting for rate setting purposes.

The consequences of violating Tax Normalization Rules are severe. The Company would lose the ability to use accelerated tax depreciation on utility assets, greatly decreasing the ADIT offset to rate base, which provides a significant benefit for our customers in the form of lower rates. The ADIT offset to rate base is forecasted to be in excess of $2 billion on a Total Company basis for the electric business.

B. IRS Proration Method is Required

The proration method is required by the Tax Normalization Rules. The purpose of the proration requirement is to prevent the flow-through of the benefits of accelerated depreciation to ratepayers any earlier than realized. The IRS assumes the benefits are received on the last day of the period over which the deferral is recognized (monthly for NSPM). If we were to follow the Department's recommendation to not use proration, the Company would be in violation of the Tax Normalization Rules and, as previously discussed, would no longer be able to take advantage of accelerated depreciation.

The requirement and the formula are described in Treasury Regulation Section 1.167(l)-1(h)(6)(ii), and examples are provided in Treasury Regulation Section 1.167(l)-1(h)(6)(iv). Section 1.167(l)-1(h)(6)(ii) of the Treasury regulations mandate the use of a very specific proration procedure in measuring the amount of future test period ADIT that can reduce rate base. This regulation requires that, if a utility uses a "future" test period to determine depreciation, "the amount of the reserve account for the period is the amount of the reserve at the beginning 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 such period."

The Company is not alone in our understanding of the IRS guidance on proration requirements. The proration requirements of Treasury Regulation Section 1.167(l)-l(h)(6) became a source for a number of inconsistent positions by different utilities. Consequently, some electric utilities requested rulings from the IRS regarding the calculation of ADIT when using forward-looking ratemaking and a true-up mechanism. In July and August 2015, the IRS Chief Counsel's Office (the National Office) issued four PLRs that, for the first time in many years, addressed the ADIT

proration requirement and some of the circumstances under which it applies.[4]

The four IRS PLRs that were published in July and August 2015 address the ADIT proration requirement and the specific normalization requirement for forecasted rate setting. In these PLRs, the IRS reasserts that in case of future test periods, the ADIT proration methodology described in Treasury Regulation Section 1.167(l)-1(h)(6) must be used. The PLRs also found that the taxpayers' Commissions and the taxpayers themselves "intended at all times to comply with the normalization rules." Because of this and because the taxpayer committed to take corrective actions the IRS determined it is not appropriate to apply the sanction of denial of accelerated depreciation to the taxpayer. A citation and discussion summary of each of these four PLRs, as well as an additional fifth PLR[5] that was released in October discussed in more detail below, is provided as Attachment B.

C. Private Letter Rulings Can and Should Be Used as Guidance

The Department states that the PLRs on which we have based our opinion that proration of the ADIT true-up is necessary do not apply to the Company. However, the Supreme Court has acknowledged that PLRs "reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws."[6] As we explain below, PLRs are often relied upon by other companies to interpret tax regulations.

The IRS strives to achieve consistency in its interpretations of tax statutes and regulations and PLRs offer understanding as to the IRS's interpretation of the IRC and related regulations. As it relates to the prorate method for ADIT for a forecast test period, the IRS has issued multiple PLRs that reach a consistent conclusion. While PLRs respond to a specific fact-pattern or transaction of the requesting company and provide audit protection only to the requesting company, they are published and made available to all. The process of publishing the rulings assists other taxpayers with similar fact patterns, avoids the requirement to submit a ruling request, and eliminates the need for the IRS to respond to such requests when there is a clear interpretation of the IRS position expressed in the PLRs.

The IRS has provided some official direction to its employees as to how PLRs and memorandums should be used and interpreted. The Internal Revenue Manual (IRM) provides that "[e]xisting private letter rulings and memorandums . . . may be used as a

[4] PLR 201531010, 201531011, and 201531012 released in July of 2015 and PLR 201532018 released in August of 2015

[5] PLR 201541010 released in October of 2015

[6] *Hanover Bank v. Commissioner*, 369 U.S. 672, 686 (1962).

guide with other research material in formulating an area office position on an issue."[7] Accordingly, practitioners frequently look to PLRs for purposes of formulating their opinion with respect to tax issues where the facts are substantially similar."

In addition, the IRS Internal Revenue Manual goes on to say that the "application of a private letter ruling is confined to the specific case for which it was issued, unless the issue involved was specifically covered by statute, regulations, ruling, opinion, or decision published in the Internal Revenue Bulletin." The pro-ration of ADIT requirement and methodology is specifically covered in Treasury Regulation Section 167(l)-l(h)(6).

D. The Company's Proposal Provides the Maximum Benefit to Customers

The Company's approach is conservative since it is preserving the rate base offset for customers and complying with IRS requirements. An aggressive position would be challenging compliance with the IRS requirements as the Department is proposing. In addition, the previously noted Tax Normalization Rules that the Company is relying on provide that the proration calculation is applicable when the Company's overall ADIT balance is increasing, as is the case presently, or *decreasing*. As such, if/when the Company's overall ADIT balance begins to reverse in the future, causing an increase to rate base, proration will reduce the amount of the ADIT reversal in a given year.

The proration adjustment could reduce the overall revenue requirement instead of increase it. When rate base is growing (plant additions outpace depreciation expense) in a year coupled with bonus depreciation, the deferred tax liability is growing as well. In this situation the proration adjustment does increase the revenue requirement overall. In contrast, when the rate base is stable (plant additions equal depreciation expense), the deferred tax liability may begin to unwind or shrink. In this situation, the proration adjustment will decrease the overall revenue requirement.

The Company is providing the entire amount of ADIT offset to rate base that it is allowed to. Congress created the Tax Normalization requirement to ensure the benefits of accelerated depreciation did not flow through to customers more quickly than intended in order to maintain an incentive for regulated utilities to make capital investments. If the Company provides more than the full amount, it would violate the Tax Normalization Rules.

[7] I.R.M. 4.10.7.2.10(4) (2006).

E. Proration Methodology is Supported By the Most Recent IRS Guidance

The Department states that our proposed ADIT treatment is inconsistent with the way ADIT has been handled for many years for ratemaking purposes. The Company believed its actions to date and the Commission's approvals were in line with the Tax Normalization Rules. However, recent IRS guidance has made the Company aware that historic ADIT treatment was not consistent with IRS regulations. Now that we understand that the Tax Normalization Rules require proration—and the utility industry and the FERC are in agreement with the need to prorate— we must make this correction going forward. The Company recommends the Commission adopt the proration method at this time. If the Commission follows this recommendation, the Company does not believe that the IRS would invoke any normalization sanctions and deny the ability to claim accelerated depreciation.

As discussed above, the Tax Normalization Rules, including recent guidance from the IRS, mandate the use of the proration method when calculating ADIT. Violation of the Tax Normalization Rules means that the Company cannot make use of the accelerated methods of depreciation and must file its taxes using the straight line basis that it uses for its financial books. While this approach would avoid a small increase to revenue requirements, it would also eliminate a large rate base reduction which would result in more customer harm than preserving normalization in ratemaking.

F. Maintaining Proration in True-Up to Actuals is Required

Should the Commission accept the prorate method for ratemaking, the Department's testimony in our current rate case[8] disputes the need to use the prorate method on the true-up calculation. As discussed above, the Commission should accept the prorate method for determining the ADIT adjustment to rate base because the prorate method is required by the Tax Normalization Rules and the consequences of violating Tax Normalization Rules are severe. In addition, the true-up must use the proration method when adjusting a forecasted rate even if the adjustment is to actuals. Recent IRS rulings as well as FERC rulings indicate this is the necessary calculation method.

A true-up is determined by reference to what was used to originally set customer rates. If a rate proceeding uses a forecast period and the rates are charged to the customers before the forecast period becomes actuals, proration must be used. The test is whether an historical or a future test period was used to set the general rates

[8] Docket No. E002/GR-15-826, Direct Testimony of Ms. Nancy Campbell

and that the rates were first charged to customers before the forecasted test year was complete. Performing a true-up at a later date does not change the fact that when rates were collected from customers, they were reduced by the benefits of accelerated depreciation before the Company received those benefits. According to PLR 201541010, "The addition of the true-up increases the ultimate accuracy of the rates but does not convert a future test period into a historical test period as those terms are used in the normalization regulations."

Our current rate case as well as our TCR rider present a forecasted test year, and the first time the rate was charged to customers is through interim rates. Therefore, the true-up must use the proration method when adjusting for actuals.

If actual ADIT is greater than the forecasted amount, the proration adjustment remains the same and is not recalculated because the incremental amount of actual ADIT over the forecasted amount will be reflected in rates *after* the test year, which is when the accelerated depreciation benefits were earned by the Company. As such, this incremental amount is not an accelerated depreciation benefit that is provided to customers before they are received by the Company, which is the situation the proration rules are concerned with. In PLR 201541010 the IRS referred to this incremental amount as the true-up component and stated that, in this instance, the actual amount added to the ADIT in the original projection is not modified by the proration formula.

The four PLRs issued in July and August 2015 addressed the ADIT proration requirement and some of the circumstances under which it applies, but they did not resolve all outstanding proration issues. The utilities that requested these PLRs did not ask specifically how the proration requirement applies to the true-up calculation. Consequently, the proration requirement at true-up, while briefly mentioned, remained uncertain.

Subsequent to the issuance of those four PLRs, in October 2015 the IRS issued a fifth PLR that affirmed the requirement to use proration and *also* clarified that proration is required in the true-up calculation in order to preserve the effect of the originally estimated proration. In this fifth PLR, the IRS stated that, "[i]n calculating the true-up, proration applies to the original projection amount,"[9] and notes that the originally projected amount is thus carried forward into the true-up, and therefore is not "unwound" by reversing the proration calculation.[10] The IRS also reasserted that in case of future test periods, the ADIT proration methodology described in Reg.

[9] IRS PLR 201541010 at 8.
[10] IRS PLR 201541010 at 12.

Sec. 1.167(l)-1(h)(6) has to be used.

The fifth PLR addressed that proration applies to the originally forecasted amount. The IRS also made it clear in this fifth PLR that the true-up process cannot be used to unwind the proration calculation of ADIT. The IRS's view is that forward-looking formula rates with true-up procedures employ a future test period subject to Tax Normalization Rules, and such formula rates must use the proration formula in estimating ADIT amounts, including carrying forward the amounts of ADIT calculated using the proration formula into the true-up. The PLR states that, "[i]n calculating the true-up, proration applies to the original projection amount." The originally projected amount is thus carried forward into the true-up, and therefore is not "unwound" by reversing the proration calculation.

Ms. Campbell's testimony discussed a PricewaterhouseCoopers (PwC) article that appears to contradict the need to prorate ADIT on true-up. This article was issued August 2015, prior to the fifth PLR (PLR 201541010) referenced above for the use of the prorate method for a true-up. We have discussed the intent of the language in the article referenced with PwC in their role as our tax advisor. We believe the Department may not have interpreted the PwC article in the manner for which it was intended with regard to the ADIT proration at true-up. While the true-up is to actual ADIT balances, the original prorated ADIT is not disturbed.

G. Recent FERC Decisions Support Proration of the True-Up Balance

In addition to the recent IRS guidance, the latest FERC actions also support our interpretation on ADIT balance treatment. The FERC initially decided that there should be no prorate on true-up in their December 30, 2015 Order in Dominion's MISO case (Docket No. ER14-1831-001). And, while they also rejected our request to clarify that there should be prorate on true-up in our MISO case (December 30, 2015 in Docket No. ER16-197), the reasoning was different as the FERC did not rule that there should be no prorate at true-up. Instead, the FERC stated that we did not fully justify our request.

However, the FERC later reversed their ruling in the Dominion case. On February 23, 2016 the FERC issued an *Order on Revised ADIT Treatment.* In this reversal order the FERC accepted Dominion's proposal to continue to apply the proration methodology to the originally projected ADIT balances in performing the annual true-up calculations. Through its September 22, 2016 *Order Denying Rehearing*, in this Dominion docket, the FERC upheld its February 23, 2016 Order accepting the ADIT proration at true-up. These Orders are provided as Attachments C and D.

The FERC has taken additional action that supports the Company's proration on true-up approach. On April 12, 2016, the FERC issued an order for formula rates for two of Xcel Energy's subsidiaries, PSCo (Public Service Company of Colorado) and SPS (Southwestern Public Service Company) in Docket Nos. ER16-236 and ER16-239. The PSCo and SPS formula rates use proration for the calculation of ADIT in the forecast and the true-up. The proration was approved by the FERC for ADIT true-up in line with the method that was approved for Dominion in February 2016. The Order is provided as Attachment E.

In response to the December 30, 2015 Order in the Company's MISO case where the FERC said the Company did not fully support its request, we filed a Motion to Lodge with the FERC on March 11, 2016 and provided additional support for our position. In addition, on September 22, 2016, the FERC issued its Order in the MISO docket clarifying that the December 30, 2015 Order does not prevent the Company from submitting tariff revisions that reflect ADIT proration at true-up. As a result, the Company intends to submit tariff revisions to the FERC providing additional support for the ADIT proration calculation. We expect FERC action on that filing before the end of 2017. This Order is provided as Attachment F.

H. FERC Tariffs Will be Updated to Use the Proration Method

The Department states that the Company is inconsistent in applying ADIT prorate between the current proceedings in Minnesota and proceedings at the FERC. Specifically, the Department references the July 25, 2016 compliance filing on behalf of Xcel Energy Transmission Development Company, LLC. (XETD), which is part of the same consolidated tax entity as NSPM.[11] The purpose of the compliance filing was to address specific issues identified in the FERC Order issued on June 23, 2016, which were unrelated to the ADIT topic.

Now that additional IRS guidance has been issued through the PLRs regarding ADIT proration, the XETD tariff will be updated to reflect the same treatment as used in Xcel Energy's recent Minnesota regulatory filings. Because XETD does not yet own operational transmission facilities (i.e., there are no assets to include in the formula rate), the ADIT treatment is not being applied by XETD to any assets at this time. The tariff will be updated to reflect the ADIT proration methodology when it is administratively appropriate at a time when other changes need to be made to the formula rate template.

[11] FERC Docket No. ER14-2752-004

I. Use of Historic Test Year for Riders is Not Warranted

With regard to the Department's alternative solution to use historical test years for riders, we note that the use of a historical test year may solve this one issue, but there are better, less drastic options to solve the ADIT proration issue at hand and a historical test year creates a whole host of new issues as well.

In an environment where capital investments are high, rates based on historical test years do not provide balanced recovery. The rates are effectively out of date as soon as the new rates go into effect. As a result, due this regulatory lag, the use of historical test years essentially prevents utilities from earning its allowed rate of return, which increases risk and the cost of capital which could eventually be reflected in higher rates. In sum, the use of forward- looking test years better represents actual costs in rates and as a result produces better results for utilities and our customers. There are better, less blunt options to solve the issue. Such a change in rider treatment has wide-ranging impacts, and there should be additional record development if the Commission would like to explore this alternative.

J. Other Minnesota Utilities Approaches

Other Minnesota utilities, like OTP, agree with the Company's interpretation of IRS guidelines regarding ADIT proration. In its recent rate case, OTP stated its "goal is to comply in good faith with a well-documented IRS normalization requirement."[12] Failure to use ADIT proration is non-compliance with the IRS normalization requirements which could result in losing the ability to take accelerated depreciation.[13]

However, regarding the ADIT true-up, some Minnesota utilities are approaching treatment of the true-up differently than Xcel Energy, though we do not know what they have based their decisions on. We have reason to believe their approach to the ADIT true-up is outdated due to the earlier timing of their filings that addressed the issue. The Company's decision to maintain ADIT proration at true-up is based on the most recent IRS rulings, FERC guidance, and numerous consultations with accounting firms, tax advisors, in-house counsel, outside counsel, and internal experts; these consultations confirm that our approach to maintaining ADIT proration in the true-up is consistent with the most recent guidance available. We do not believe we have the choice of not maintaining ADIT proration in a true-up calculation if we are to remain in compliance with the Tax Normalization Rules.

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[12] *In the Matter of the Application of Otter Tail Power Company for Authority to Increase Rates for Electric Utility Service in Minnesota*, Docket No. E017/GR-15-1033, Rebuttal Testimony of Stuart D. Tommerdahl, page 17.
[13] Id. at pages 17-18.

K. Customers Would Be Harmed if ADIT is Not Prorated

If the Company is ordered to violate Tax Normalization rules by not being allowed to prorate the ADIT, customers would be harmed. If the Company is not able to use accelerated depreciation, then tax depreciation would revert to straight-line depreciation over the useful life of the assets, or what is commonly known as book depreciation. Using book depreciation for tax would eliminate any increase in ADIT rate base deduction going forward. Thus, the beginning deferred balance would stop increasing and would decrease causing a substantial increase to revenue requirements. For 2016, the average ADIT offset to rate base is forecasted to be in excess of $2 billion on a Total Company basis. A violation would cause this $2 billion balance to systematically go away, which would increase the return on rate base in general rates. Additionally, the Company and ratepayers would not have access to any accelerated depreciation, including bonus depreciation resulting from the PATH Act or enacted by Congress going forward.[14] Therefore, proration of ADIT is in the best interests of customers to keep their rates lower.

L. Benefits of Deferring a Commission Decision

A number of proceedings are in progress which may bring more clarity to the ADIT proration treatment issue. It may be beneficial to wait to have a further developed record on this issue in other currently pending Commission proceedings. In addition, the FERC has clarified that the Company may submit a revised tariff applying the ADIT proration to the true-up. We expect a FERC decision approving our revised tariff, consistent with the PSCo and SPS tariff treatment of the ADIT true-up proration, by the end of 2017. Further IRS guidance may also be forthcoming. If necessary, we could potentially submit our own PLR to the IRS for a definitive ruling.

If additional guidance from the IRS, the FERC, or Commission proceedings shows our ADIT treatment to be unsupported, we would credit to customers any difference through the TCR tracker. We also agree to bring forward to the Commission any newly issued guidance as it emerges to help clarify the issue.

[14] Specifically, the Protecting Americans from Tax Hikes Act of 2015 (PATH Act) which is part of the Consolidated Appropriations Act of 2016.

CONCLUSION

We appreciate the opportunity to respond to the Department's Response Comments. We respectfully request the Commission approve our Petition as supplemented on November 6, 2015 and through our Reply Comments, confirm ADIT proration is appropriate, and defer a decision on the treatment of ADIT at true-up to a future proceeding.

Dated: September 29, 2016

Northern States Power Company

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§168 Accelerated cost recovery system.

Internal Revenue Code

§ 168 Accelerated cost recovery system.

. . . . . .

(f) Property to which section does not apply.
This section shall not apply to—

(1) Certain methods of depreciation.
Any property if—

(A) the taxpayer elects to exclude such property from the application of this section , and

(B) for the 1st taxable year for which a depreciation deduction would be allowable with respect to such property in the hands of the taxpayer, the property is properly depreciated under the unit-of-production method or any method of depreciation not expressed in a term of years (other than the retirement-replacement-betterment method or similar method).

(2) Certain public utility property.
Any public utility property (within the meaning of subsection (i)(10)) if the taxpayer does not use a normalization method of accounting.

. . . . . .

(i) Definitions and special rules.
For purposes of this section —

(9) Normalization rules.

(A) In general. In order to use a normalization method of accounting with respect to any public utility property for purposes of subsection (f)(2) —

(i) the taxpayer must, in computing its tax expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, use a method of depreciation with respect to such property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for such purposes; and

(ii) if the amount allowable as a deduction under this section with respect to such property differs from the amount that would be allowable as a deduction under section 167 using the method (including the period, first and last year convention, and salvage value) used to compute regulated tax expense under clause (i) , the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

(B) Use of inconsistent estimates and projections, etc.

(i) In general. One way in which the requirements of subparagraph (A) are not met is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with the requirements of subparagraph (A) .

(ii) Use of inconsistent estimates and projections. The procedures and adjustments which are to be treated as inconsistent for purposes of clause (i) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under subparagraph (A)(ii) unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.

(iii) Regulatory authority. The Secretary may by regulations prescribe procedures and adjustments (in addition to those specified in clause (ii)) which are to be treated as inconsistent for purposes of clause (i) .

(C) Public utility property which does not meet normalization rules. In the case of any public utility property to which this section does not apply by reason of subsection (f)(2) , the allowance for depreciation under section 167(a) shall be an amount computed using the method and period referred to in subparagraph (A)(i) .

(10) Public utility property.
The term “public utility property” means property used predominantly in the trade or business of the furnishing or sale of—

(A) electrical energy, water, or sewage disposal services,

(B) gas or steam through a local distribution system,

(C) telephone services, or other communication services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. 701), or

(D) transportation of gas or steam by pipeline,

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

. . . . . .

PLR No. 201541010

In this PLR, the Service held that if rates are in effect during the future test year, the proration formula must be used. The addition of the true-up increases the ultimate accuracy of the rates but does not convert a future test period into a historical test period as those terms are used in the normalization regulations. Therefore, Taxpayer was required to apply the proration formula in calculating accumulated deferred income taxes for purposes of calculating rate base. The Service held that in calculating the true-up, proration applies to the original projection amount but the actual amount added to the ADFIT over the test year is not modified by application of the proration formula.

The Service also held that taxpayers may not adopt any accounting treatment that directly or indirectly circumvents the normalization rules. The Commission for Taxpayer proposed to adjust the cash working capital allowance specifically to mitigate the effect of the application of the proration methodology. The Service held that this was inconsistent with the normalization rules.

The Service also held that minor inconsistencies in averaging convention for different components of rate base did not cause a normalization violation.

PLR No. 201531010

This PLR addresses the same issues and arrives at the same conclusions as PLR 201532018.

PLR No. 201531011

This PLR addresses the same issues and arrives at the same conclusions as PLR 201532018.

PLR No. 201531012

This PLR addresses the same issues and arrives at the same conclusions as PLR 201532018.

PLR No. 201532018

In this PLR, the Service provided a discussion on "historical" vs. "future" periods for purposes of ADIT proration. The "future" portion of a test period starts when rates become effective and ADIT proration is required. In addition, the Service held that the addition of the true-up increases the ultimate accuracy of the rates but does not convert a future test period into a historical test period as those terms are used in the normalization regulations. Therefore, even at true-up, Taxpayer is still required to apply the proration formula in calculating accumulated deferred income taxes for purposes of calculating rate base. If a taxpayer chooses to compute its ratemaking tax expense and rate base exclusion amount using projected data then it must use the proration formula provided in the regulations to calculate the amount of deferred taxes subject to exclusion from the rate base. In addition, the Service held that minor discrepancy in averaging conventions for components of rate base does not violate normalization rules. Computation of average rate base with reference to 13-month average for plant and accumulated depreciation for given service year and simple average of beginning and end of year balances for accumulated deferred taxes for the same service year complied with consistency requirements of normalization rules for accelerated depreciation.

These PLRs also found that the taxpayers' Commissions and the taxpayers themselves "intended at all times to comply with the normalization rules." Because of this and because the taxpayer committed to take corrective actions it is not appropriate to apply the sanction of denial of accelerated depreciation to the taxpayer.

Private Letter Rulings

Private Letter Ruling 201531010, 07/31/2015, IRC Sec(s). 167

UIL No. 167.22-01

Depreciation-accelerated cost recovery system-compuation of average rate base-accumulated deferred taxes-normalization rules-consistency requirements.

Headnote:

Independent transmission utility's computation of average rate base with reference to 13-month average for plant and accumulated depreciation for given service year and simple average of beginning and end of year balances for accumulated deferred taxes for same service year complied with **Code Sec. 168(i)(9)(B);** 's consistency requirements of normalization rules for accelerated depreciation.

Reference(s): **Code Sec. 167; Code Sec. 168;**

Full Text:

Number: **201531010**

Release Date: 7/31/2015

Index Number: 167.22-01

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-140120-14

Date:

April 14, 2015

LEGEND:

Taxpayer =

Parent =

State =

Commission =

Date A =

Director =

Dear [Redacted Text]:

This letter responds to Parent's request, made on behalf of Taxpayer, dated October 23, 2014, for a ruling on the consequences under the normalization provisions of Taxpayer's use of the Commission-approved formula rates as described below.

The representations set out in your letter follow.

Taxpayer, a single member limited liability company, is an independent transmission utility engaged in the transmission of electricity and operates a high-voltage system in State. It is subject to regulation by Commission with respect to terms and conditions of services, including the rates it may charge for its services. Taxpayer uses Commission-approved formula rates that are set annually. The formula uses a cost-of-service model. On Date A of each year, Taxpayer estimates its revenue requirement for the

following calendar year, the service year, based in part on the facilities in service at that time or expected to be placed in service during that year. This estimate of Taxpayer's revenue requirement and a Commission-approved rate of return are entered into the template for the formula to calculate the rates. The rates for that calendar year are determined under that formula approved by Commission and go into effect on January 1 of the following calendar year with no additional action by Commission.

In calculating its net annual revenue requirement for the formula, Taxpayer calculates average rate base. All elements of average rate base are calculated using the same test period, the service year. Taxpayer reduces its gross rate base by the average accumulated deferred income taxes. When Taxpayer estimates accumulated deferred income taxes for purposes of estimating it's revenue requirement for the service year, Taxpayer does not use the proration formula required for future test periods by  section 1.167(l)-1(h)(6) of the Income Tax Regulations. Average rate base is computed using monthly averages for plant balances, including accumulated depreciation. For this purpose, depreciation begins when the asset is placed in service. Certain other elements of average rate base, such as land held for future use, materials and supplies, prepayments, and accumulated deferred income taxes are calculated using an average of the beginning and end of year balances. In both cases, the averages are calculated in accordance with the provisions of the Commission-approved template.

The formula rate template contains a "true-up" mechanism under which the Taxpayer compares its actual revenue requirement to its actually-billed revenues for the service year. If billed revenue is greater than the actual revenue requirement for the service year the over-collection is refunded in customer bills within two years of the service year; if billed revenue is less than the actual revenue requirement for the service year the under-collection is collected two years after the service year. For both under and over collections, a carrying charge equivalent to Commission's standard refund interest rate is imposed.

Commission at all times has required that all public utilities under its jurisdiction use normalized methods of accounting.

Taxpayer requests that we rule as follows:

> 1. The computation of average rate base by Taxpayer with reference to 13-month average for plant and accumulated depreciation for a given service year and a simple average of the beginning- and end-of-year balances for accumulated deferred income taxes for the same service year complies with the consistency requirement of the normalization rules for accelerated depreciation under  section 168(i)(9)(B) of the Internal Revenue Code.
>
> 2. In the event that the Service does not agree with the Taxpayer's conclusion regarding the first issue, Taxpayer's historical use of the averaging methodology described above is nevertheless not inconsistent with the requirements of  §168(i)(9)(B) and therefore the sanctions for violation of the deferred tax normalization requirements involving disallowance

of accelerated depreciation do not apply to Taxpayer as a result of its use of the historical averaging methodology employed.

3. The computation by Taxpayer of accumulated deferred income taxes for purposes of calculating average rate base without application of the rules for future test periods under § 1.167(l)-1(h)(6) involving the proration formula complies with the normalization requirements of § 168(i)(9).

4. In the event that the Service does not agree with the Taxpayer's conclusion regarding Issue 2, sanctions for violation of the deferred tax normalization requirements involving disallowance of accelerated depreciation do not apply as a result of the methodology employed.

Law and Analysis

Issues 1 and 2

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 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) requires that a taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is 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.

In order to satisfy the requirements of §168(i)(9)(B), there must be consistency in the treatment of costs for rate base, regulated depreciation expense, tax expense, and deferred tax revenue purposes. Here, rate base, depreciation expense, and accumulated deferred income taxes are all calculated in consistent fashion - all are averaged over the same period. While there are minor differences in the convention used to average all elements of rate base including depreciation expense on the one hand, and accumulated deferred income taxes on the other, for purposes of §168(i)(9)(B), it is sufficient that both are determined by averaging and both are determined over the same period of time. Thus, the calculation of average rate base and accumulated deferred income taxes as described above complies with the consistency requirement of §168(i)(9)(B).

Because of the conclusion reached above, Taxpayer's second issue is moot and will not be considered further.

Issue 3

Section 1.167(l)-1(h)(6) sets forth additional normalization requirements with respect to public utility property. Under § 1.167(l)-1(h)(6)(i), a taxpayer does not use a normalization method of accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes excluded from the rate base, or treated as cost-free capital, exceeds the amount of the reserve for the period used in determining the taxpayer's ratemaking tax expense. Section 1.167(l)-1(h)(6)(ii) also provides the procedure for determining the amount of the reserve for deferred taxes to be excluded from rate base or to be included as no-cost capital. If, in determining depreciation for ratemaking tax expense, a period (the "test period") is used which is part historical and part future, then the amount of the reserve account for

this period is the amount of the reserve at the end of the historical portion of the period and a pro rata amount of any projected increase to be credited to the account during the future portion of the period. The pro rata amount of any increase during the future portion of the period is determined by multiplying the increase by a fraction, the numerator of which is the number of days remaining in the period at the time the increase is to accrue, and the denominator of which is the total number of days in the future portion of the period.

Section 1.167(l)-1(h)(6)(i) makes it clear that the reserve excluded from rate base must be determined by reference to the same period as is used in determining ratemaking tax expense. A taxpayer may use either historical data or projected data in calculating these two amounts, but it must be consistent. As explained in section 1.167(l)-1(a)(1), the rules provided in section 1.167(l)-1(h)(6)(i) are to insure that the same time period is used to determine the deferred tax reserve amount resulting from the use of an accelerated method of depreciation for cost of service purposes and the reserve amount that may be excluded from the rate base or included in no-cost capital in determining such cost of services.

If a taxpayer chooses to compute its ratemaking tax expense and rate base exclusion amount using projected data then it must use the formula provided in section 1.167(l)-1(h)(6)(ii) to calculate the amount of deferred taxes subject to exclusion from the rate base. This formula prorates the projected accruals to the reserve so as to account for the actual time these amounts are expected to be in the reserve. As explained in § 1.167(l)-1(a)(1), the formula in section 1.167(l)-1(h)(6)(ii) provides a method to determine the period of time during which the taxpayer will be treated as having received amounts credited or charged to the reserve account so that the disallowance of earnings with respect to such amounts through rate base exclusion or treatment as no-cost capital will take into account the factor of time for which such amounts are held by the taxpayer.

The purpose of the proration formula is the same as that of the requirement for consistent periods discussed above: to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers. The proration formula stops flow-through by limiting the deferred tax reserve accruals that may be excluded from rate base, and thus the earnings on rate base that may be disallowed, according to the length of time these accruals are actually in the reserve account.

The effectiveness of § 1.167(l)-1(h)(6)(ii) in resolving the timing issue has been limited by its failure to define some key terms. Nowhere does this provision state what is meant by the terms "historical" and "future" in relation to the period for determining depreciation for ratemaking tax expense (the "test period"). How are these time periods to be measured§ One interpretation focuses on the type or quality of the data used in the ratemaking process. According to this interpretation, the historical period is that portion of the test period for which actual data is used, while the portion of the period for which data is estimated is the future period. The second interpretation focuses on when the utility rates become

effective. Under this interpretation, the historical period is that portion of the test period before rates go into effect, while the portion of the test period after the effective date of the rate order is the future period.

The first interpretation, which focuses on the quality of the ratemaking data, is an attractive one. It proposes a simple rule, easy to follow and to enforce: any portion of the reserve for deferred taxes based on estimated data must be prorated in determining the amount to be deducted from rate base. The actual passage of time between the date ratemaking data is submitted and the date rates become effective is of no importance. But this interpretation of the regulations achieves simplicity at the expense of precision; in other words, it is overbroad. The proration of all estimated deferred tax data does serve to magnify the benefits of accelerated depreciation to the utility, but this is not the purpose of normalization. Congress was explicit: normalization "in no way diminishes whatever power the [utility regulatory] agency may have to require that the deferred taxes reserve be excluded from the base upon which the utility's permitted rate of return is calculated." H.R. Rep. No. 413, 91st Cong., 1st Sess. 133 (1969).

In contrast, the second interpretation of  section 1.167(l)-1(h)(6)(ii) of the regulations is consistent with the purpose of normalization, which is to preserve for regulated utilities the benefits of accelerated depreciation as a source of cost-free capital. The availability of this capital is ensured by prohibiting flow-through. But whether or not flow-through can even be accomplished by means of rate base exclusions depends primarily on whether, at the time rates become effective, the amounts originally projected to accrue to the deferred tax reserve have actually accrued.

If rates go into effect before the end of the test period, and the rate base reduction is not prorated, the utility commission is denying a current return for accelerated depreciation benefits the utility is only projected to have. This procedure is a form of flow-through, for current rates are reduced to reflect the capital cost savings of accelerated depreciation deductions not yet claimed or accrued by the utility. Yet projected data is often necessary in determining rates, since historical data by itself is rarely an accurate indication of future utility operating results. Thus, the regulations provide that as long as the portion of the deferred tax reserve based on truly projected (future estimated) data is prorated according to the formula in  section 1.167(l)-1(h)(6)(ii), a regulator may deduct this reserve from rate base in determining a utility's allowable return. In other words, a utility regulator using projected data in computing ratemaking tax expense and rate base exclusion must account for the passage of time if it is to avoid flow-through.

But if rates go into effect after the end of the test period, the opportunity to flow through the benefits of future accelerated depreciation to current ratepayers is gone, and so too is the need to apply the proration formula. In this situation, the only question that is important for the purpose of rate base exclusion is the amount in the deferred tax reserve, whether actual or estimated. Once the future period, the period over which accruals to the reserve were projected, is no longer future, the question of when the amounts in the reserve accrued is no longer relevant (at the time the new rate order takes

effect, the projected increases have accrued, and the amounts to be excluded from rate base are no longer projected but historical, even though based on estimates).

Taxpayer uses formula rates with the elements determined by estimates of the various elements being averaged as discussed above. Rates go into effect as of the beginning of the service year. **1** As such, the rates are in effect during the test year and the proration formula must be used. The addition of the true up increases the ultimate accuracy of the rates but does not convert a future test period into a historical test period as those terms are used in the normalization regulations. Therefore, Taxpayer is required to apply the proration formula in calculating accumulated deferred income taxes for purposes of calculating rate base.

Issue 4

Because the Service has ruled in Issue 3 that Taxpayer's use of formula rates with true-up adjustments with carrying charges mandates use of the proration formula applicable to future test periods for the projected revenue requirement, prospectively adhering to the Service's interpretation of § 1.167(l)-1(h)(6)(ii) may require Taxpayer to seek and obtain an order from Commission to make the necessary changes to the rate templates, not simply unilaterally adjusting the calculations (or the manner in which the templates are completed) in the next annual projections or true-up adjustments. If Taxpayer must request these changes through a filing with Commission, Taxpayer has represented that, in the event of an adverse conclusion with respect to Issue 3 by the Service, it will make a filing with Commission to amend its formula rate template within six months of receipt of this ruling letter, requesting that Commission apply a methodology in accordance with this letter using an effective date of the first month following the date of the filing made with Commission. Following Commission's order in that filing, Taxpayer will prospectively apply the methodology consistent with this letter approved by Commission. Until Commission acts on the filing, Taxpayer will continue to use the methodology described above.

If Taxpayer determines that it is not required to make a formal filing with Commission to implement the computational changes required by the letter ruling, Taxpayer would reflect the holding of the private letter ruling in its next annual projected revenue requirement filing. For example, assuming that the letter ruling is received in April 2015 indicating that the projected revenue requirement is based solely on a future period and the actual revenue requirement used for the true-up mechanism is based solely on a historical period, Taxpayer would compute its year-end accumulated deferred income tax amount for its beginning-of-year/end-of-year average of accumulated deferred income taxes based on application of the proration formula to the monthly net increases or decreases to its accumulated deferred income taxes for annual projected revenue requirement filings after receipt of the private letter ruling (i.e., beginning with the filing due September 1, 2015, for the calendar-year 2016 test year and service period).

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. However, in the legislative history to the enactment of the normalization requirements of the Investment Tax Credit, Congress has stated that it hopes that sanctions will not have to be imposed and that disallowance of the tax benefit (there, the ITC) should be imposed only after a regulatory body has required or insisted upon such treatment by a utility. See Senate Report No. 92-437, 92nd Cong., 1st Sess. 40-41 (1971), 1972-2 C.B. 559, 581.

Here, Taxpayer has used a template approved by Commission to calculate formula-based rates. Commission has, at all times, required that utilities under its jurisdiction use normalization methods of accounting. Taxpayer also intended at all times to comply with the normalization rules. However, Taxpayer concluded that the use of the true-up would allow the entirety of the rate calculation to be considered a purely historical period and thus not require the application of the proration formula described in § 1.167(l)-1(h)(6)(ii). As concluded above, this conclusion is not in accord with the normalization rules. However because both Commission and Taxpayer at all times sought to comply, because Taxpayer merely populated a Commission-approved formula template rather than Commission carefully considering the calculation and ordering its use by Taxpayer, and because Taxpayer will take the corrective actions described above, it is not currently appropriate to apply the sanction of denial of accelerated depreciation to Taxpayer.

Conclusions

1. The computation of average rate base by Taxpayer with reference to 13-month average for plant and accumulated depreciation for a given service year and a simple average of the beginning- and end-of-year balances for accumulated deferred income taxes for the same service year complies with the consistency requirement of the normalization rules for accelerated depreciation under section 168(i)(9)(B) of the Internal Revenue Code.

2. Because of the conclusion reached in Issue 1, Issue 2 is moot.

3. The computation by Taxpayer of accumulated deferred income taxes for purposes of calculating average rate base without application of the rules for future test periods under § 1.167(l)-1(h)(6) involving the proration formula for its projected revenue requirement does not comply with the normalization requirements of § 168(i)(9). The computation by Taxpayer of accumulated deferred income taxes for purposes of calculating average rate base without application of the rules for future test periods under § 1.167(l)-1(h)(6) involving the proration formula for its actual revenue requirement used for the true-up mechanism complies with the normalization requirements of § 168(i)(9).

4. If the Taxpayer takes the corrective actions described above, and assuming compliance by the Commission with this methodology on a prospective basis, sanctions for violation of the

deferred tax normalization requirements involving disallowance of accelerated depreciation do not apply as a result of the methodology employed.

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

Office of the Associate Chief Counsel

(Passthroughs & Special Industries)

1 We note that, because Taxpayer is using estimated data for the test period, the test period at issue here constitutes a "future test period" under the first interpretation discussed above as well.

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Private Letter Rulings

Private Letter Ruling 201531011, 07/31/2015, IRC Sec(s). 167

UIL No. 167.22-01

Depreciation-accelerated cost recovery system-compuation of average rate base-accumulated deferred taxes-normalization rules-consistency requirements.

Headnote:

Independent transmission utility's computation of average rate base with reference to 13-month average for plant and accumulated depreciation for given service year and simple average of beginning and end of year balances for accumulated deferred taxes for same service year complied with **Code Sec. 168(i)(9)(B);** 's consistency requirements of normalization rules for accelerated depreciation.

Reference(s): **Code Sec. 167; Code Sec. 168;**

Full Text:

Number: **201531011**

Release Date: 7/31/2015

Index Number: 167.22-01

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-140121-14

Date:

April 15, 2015

LEGEND:

Taxpayer =

Parent =

State =

Commission =

Date A =

Director =

Dear [Redacted Text]:

This letter responds to Parent's request, made on behalf of Taxpayer, dated October 23, 2014, for a ruling on the consequences under the normalization provisions of Taxpayer's use of the Commission-approved formula rates as described below.

The representations set out in your letter follow.

Taxpayer, a single member limited liability company indirectly owned by parent, is an independent transmission utility engaged in the transmission of electricity and operates a high-voltage system in State. It is disregarded for federal income tax purposes. Taxpayer is subject to regulation by Commission with respect to terms and conditions of services, including the rates it may charge for its services. Taxpayer uses Commission-approved formula rates that are set annually. The formula uses a

cost-of-service model. On Date A of each year, Taxpayer estimates its revenue requirement for the following calendar year, the service year, based in part on the facilities in service at that time or expected to be placed in service during that year. This estimate of Taxpayer's revenue requirement and a Commission-approved rate of return are entered into the template for the formula to calculate the rates. The rates for that calendar year are determined under that formula approved by Commission and go into effect on January 1 of the following calendar year with no additional action by Commission.

In calculating its net annual revenue requirement for the formula, Taxpayer calculates average rate base. All elements of average rate base are calculated using the same test period, the service year. Taxpayer reduces its gross rate base by the average accumulated deferred income taxes. When Taxpayer estimates accumulated deferred income taxes for purposes of estimating it's revenue requirement for the service year, Taxpayer does not use the proration formula required for future test periods by section 1.167(l)-1(h)(6) of the Income Tax Regulations. Average rate base is computed using monthly averages for plant balances, including accumulated depreciation. For this purpose, depreciation begins when the asset is placed in service. Certain other elements of average rate base, such as land held for future use, materials and supplies, prepayments, and accumulated deferred income taxes are calculated using an average of the beginning and end of year balances. In both cases, the averages are calculated in accordance with the provisions of the Commission-approved template.

The formula rate template contains a "true-up" mechanism under which the Taxpayer compares its actual revenue requirement to its actually-billed revenues for the service year. If billed revenue is greater than the actual revenue requirement for the service year the over-collection is refunded in customer bills within two years of the service year; if billed revenue is less than the actual revenue requirement for the service year the under-collection is collected two years after the service year. For both under and over collections, a carrying charge equivalent to Commission's standard refund interest rate is imposed.

Commission at all times has required that all public utilities under its jurisdiction use normalized methods of accounting.

Taxpayer requests that we rule as follows:

> 1. The computation of average rate base by Taxpayer with reference to 13-month average for plant and accumulated depreciation for a given service year and a simple average of the beginning- and end-of-year balances for accumulated deferred income taxes for the same service year complies with the consistency requirement of the normalization rules for accelerated depreciation under section 168(i)(9)(B) of the Internal Revenue Code.
>
> 2. In the event that the Service does not agree with the Taxpayer's conclusion regarding the first issue, Taxpayer's historical use of the averaging methodology described above is nevertheless not inconsistent with the requirements of § 168(i)(9)(B) and therefore the

sanctions for violation of the deferred tax normalization requirements involving disallowance of accelerated depreciation do not apply to Taxpayer as a result of its use of the historical averaging methodology employed.

3. The computation by Taxpayer of accumulated deferred income taxes for purposes of calculating average rate base without application of the rules for future test periods under § 1.167(l)-1(h)(6) involving the proration formula complies with the normalization requirements of § 168(i)(9).

4. In the event that the Service does not agree with the Taxpayer's conclusion regarding Issue 2, sanctions for violation of the deferred tax normalization requirements involving disallowance of accelerated depreciation do not apply as a result of the methodology employed.

Law and Analysis

Issues 1 and 2

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 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) requires that a taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is 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.

In order to satisfy the requirements of §168(i)(9)(B), there must be consistency in the treatment of costs for rate base, regulated depreciation expense, tax expense, and deferred tax revenue purposes. Here, rate base, depreciation expense, and accumulated deferred income taxes are all calculated in consistent fashion - all are averaged over the same period. While there are minor differences in the convention used to average all elements of rate base including depreciation expense on the one hand, and accumulated deferred income taxes on the other, for purposes of §168(i)(9)(B), it is sufficient that both are determined by averaging and both are determined over the same period of time. Thus, the calculation of average rate base and accumulated deferred income taxes as described above complies with the consistency requirement of §168(i)(9)(B).

Because of the conclusion reached above, Taxpayer's second issue is moot and will not be considered further.

Issue 3

Section 1.167(l)-1(h)(6) sets forth additional normalization requirements with respect to public utility property. Under § 1.167(l)-1(h)(6)(i), a taxpayer does not use a normalization method of accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes excluded from the rate base, or treated as cost-free capital, exceeds the amount of the reserve for the period used in determining the taxpayer's ratemaking tax expense. Section 1.167(l)-1(h)(6)(ii) also provides the procedure for determining the amount of the reserve for deferred taxes to be excluded from rate base or to be included as no-cost capital. If, in determining depreciation for ratemaking tax expense, a period (the

"test period") is used which is part historical and part future, then the amount of the reserve account for this period is the amount of the reserve at the end of the historical portion of the period and a pro rata amount of any projected increase to be credited to the account during the future portion of the period. The pro rata amount of any increase during the future portion of the period is determined by multiplying the increase by a fraction, the numerator of which is the number of days remaining in the period at the time the increase is to accrue, and the denominator of which is the total number of days in the future portion of the period.

Section 1.167(l)-1(h)(6)(i) makes it clear that the reserve excluded from rate base must be determined by reference to the same period as is used in determining ratemaking tax expense. A taxpayer may use either historical data or projected data in calculating these two amounts, but it must be consistent. As explained in section 1.167(l)-1(a)(1), the rules provided in section 1.167(l)-1(h)(6)(i) are to insure that the same time period is used to determine the deferred tax reserve amount resulting from the use of an accelerated method of depreciation for cost of service purposes and the reserve amount that may be excluded from the rate base or included in no-cost capital in determining such cost of services.

If a taxpayer chooses to compute its ratemaking tax expense and rate base exclusion amount using projected data then it must use the formula provided in section 1.167(l)-1(h)(6)(ii) to calculate the amount of deferred taxes subject to exclusion from the rate base. This formula prorates the projected accruals to the reserve so as to account for the actual time these amounts are expected to be in the reserve. As explained in § 1.167(l)-1(a)(1), the formula in section 1.167(l)-1(h)(6)(ii) provides a method to determine the period of time during which the taxpayer will be treated as having received amounts credited or charged to the reserve account so that the disallowance of earnings with respect to such amounts through rate base exclusion or treatment as no-cost capital will take into account the factor of time for which such amounts are held by the taxpayer.

The purpose of the proration formula is the same as that of the requirement for consistent periods discussed above: to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers. The proration formula stops flow-through by limiting the deferred tax reserve accruals that may be excluded from rate base, and thus the earnings on rate base that may be disallowed, according to the length of time these accruals are actually in the reserve account.

The effectiveness of § 1.167(l)-1(h)(6)(ii) in resolving the timing issue has been limited by its failure to define some key terms. Nowhere does this provision state what is meant by the terms "historical" and "future" in relation to the period for determining depreciation for ratemaking tax expense (the "test period"). How are these time periods to be measured? One interpretation focuses on the type or quality of the data used in the ratemaking process. According to this interpretation, the historical period is that portion of the test period for which actual data is used, while the portion of the period for which data is

estimated is the future period. The second interpretation focuses on when the utility rates become effective. Under this interpretation, the historical period is that portion of the test period before rates go into effect, while the portion of the test period after the effective date of the rate order is the future period.

The first interpretation, which focuses on the quality of the ratemaking data, is an attractive one. It proposes a simple rule, easy to follow and to enforce: any portion of the reserve for deferred taxes based on estimated data must be prorated in determining the amount to be deducted from rate base. The actual passage of time between the date ratemaking data is submitted and the date rates become effective is of no importance. But this interpretation of the regulations achieves simplicity at the expense of precision; in other words, it is overbroad. The proration of all estimated deferred tax data does serve to magnify the benefits of accelerated depreciation to the utility, but this is not the purpose of normalization. Congress was explicit: normalization "in no way diminishes whatever power the [utility regulatory] agency may have to require that the deferred taxes reserve be excluded from the base upon which the utility's permitted rate of return is calculated." H.R. Rep. No. 413, 91st Cong., 1st Sess. 133 (1969).

In contrast, the second interpretation of  section 1.167(l)-1(h)(6)(ii) of the regulations is consistent with the purpose of normalization, which is to preserve for regulated utilities the benefits of accelerated depreciation as a source of cost-free capital. The availability of this capital is ensured by prohibiting flow-through. But whether or not flow-through can even be accomplished by means of rate base exclusions depends primarily on whether, at the time rates become effective, the amounts originally projected to accrue to the deferred tax reserve have actually accrued.

If rates go into effect before the end of the test period, and the rate base reduction is not prorated, the utility commission is denying a current return for accelerated depreciation benefits the utility is only projected to have. This procedure is a form of flow-through, for current rates are reduced to reflect the capital cost savings of accelerated depreciation deductions not yet claimed or accrued by the utility. Yet projected data is often necessary in determining rates, since historical data by itself is rarely an accurate indication of future utility operating results. Thus, the regulations provide that as long as the portion of the deferred tax reserve based on truly projected (future estimated) data is prorated according to the formula in  section 1.167(l)-1(h)(6)(ii), a regulator may deduct this reserve from rate base in determining a utility's allowable return. In other words, a utility regulator using projected data in computing ratemaking tax expense and rate base exclusion must account for the passage of time if it is to avoid flow-through.

But if rates go into effect after the end of the test period, the opportunity to flow through the benefits of future accelerated depreciation to current ratepayers is gone, and so too is the need to apply the proration formula. In this situation, the only question that is important for the purpose of rate base exclusion is the amount in the deferred tax reserve, whether actual or estimated. Once the future period, the period over which accruals to the reserve were projected, is no longer future, the question of

when the amounts in the reserve accrued is no longer relevant (at the time the new rate order takes effect, the projected increases have accrued, and the amounts to be excluded from rate base are no longer projected but historical, even though based on estimates).

Taxpayer uses formula rates with the elements determined by estimates of the various elements being averaged as discussed above. Rates go into effect as of the beginning of the service year. **1** As such, the rates are in effect during the test year and the proration formula must be used. The addition of the true up increases the ultimate accuracy of the rates but does not convert a future test period into a historical test period as those terms are used in the normalization regulations. Therefore, Taxpayer is required to apply the proration formula in calculating accumulated deferred income taxes for purposes of calculating rate base.

Issue 4

Because the Service has ruled in Issue 3 that Taxpayer's use of formula rates with true-up adjustments with carrying charges mandates use of the proration formula applicable to future test periods for the projected revenue requirement, prospectively adhering to the Service's interpretation of  § 1.167(l)-1(h)(6)(ii) may require Taxpayer to seek and obtain an order from Commission to make the necessary changes to the rate templates, not simply unilaterally adjusting the calculations (or the manner in which the templates are completed) in the next annual projections or true-up adjustments. If Taxpayer must request these changes through a filing with Commission, Taxpayer has represented that, in the event of an adverse conclusion with respect to Issue 3 by the Service, it will make a filing with Commission to amend its formula rate template within six months of receipt of this ruling letter, requesting that Commission apply a methodology in accordance with this letter using an effective date of the first month following the date of the filing made with Commission. Following Commission's order in that filing, Taxpayer will prospectively apply the methodology consistent with this letter approved by Commission. Until Commission acts on the filing, Taxpayer will continue to use the methodology described above.

If Taxpayer determines that it is not required to make a formal filing with Commission to implement the computational changes required by the letter ruling, Taxpayer would reflect the holding of the private letter ruling in its next annual projected revenue requirement filing. For example, assuming that the letter ruling is received in April 2015 indicating that the projected revenue requirement is based solely on a future period and the actual revenue requirement used for the true-up mechanism is based solely on a historical period, Taxpayer would compute its year-end accumulated deferred income tax amount for its beginning-of-year/end-of-year average of accumulated deferred income taxes based on application of the proration formula to the monthly net increases or decreases to its accumulated deferred income taxes for annual projected revenue requirement filings after receipt of the private letter ruling (i.e., beginning with the filing due September 1, 2015, for the calendar-year 2016 test year and service period).

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. However, in the legislative history to the enactment of the normalization requirements of the Investment Tax Credit, Congress has stated that it hopes that sanctions will not have to be imposed and that disallowance of the tax benefit (there, the ITC) should be imposed only after a regulatory body has required or insisted upon such treatment by a utility. See Senate Report No. 92-437, 92nd Cong., 1st Sess. 40-41 (1971), 1972-2 C.B. 559, 581.

Here, Taxpayer has used a template approved by Commission to calculate formula-based rates. Commission has, at all times, required that utilities under its jurisdiction use normalization methods of accounting. Taxpayer also intended at all times to comply with the normalization rules. However, Taxpayer concluded that the use of the true-up would allow the entirety of the rate calculation to be considered a purely historical period and thus not require the application of the proration formula described in § 1.167(l)-1(h)(6)(ii). As concluded above, this conclusion is not in accord with the normalization rules. However because both Commission and Taxpayer at all times sought to comply, because Taxpayer merely populated a Commission-approved formula template rather than Commission carefully considering the calculation and ordering its use by Taxpayer, and because Taxpayer will take the corrective actions described above, it is not currently appropriate to apply the sanction of denial of accelerated depreciation to Taxpayer.

Conclusions

1. The computation of average rate base by Taxpayer with reference to 13-month average for plant and accumulated depreciation for a given service year and a simple average of the beginning- and end-of-year balances for accumulated deferred income taxes for the same service year complies with the consistency requirement of the normalization rules for accelerated depreciation under section 168(i)(9)(B) of the Internal Revenue Code.

2. Because of the conclusion reached in Issue 1, Issue 2 is moot.

3. The computation by Taxpayer of accumulated deferred income taxes for purposes of calculating average rate base without application of the rules for future test periods under § 1.167(l)-1(h)(6) involving the proration formula for its projected revenue requirement does not comply with the normalization requirements of § 168(i)(9). The computation by Taxpayer of accumulated deferred income taxes for purposes of calculating average rate base without application of the rules for future test periods under § 1.167(l)-1(h)(6) involving the proration formula for its actual revenue requirement used for the true-up mechanism complies with the normalization requirements of § 168(i)(9).

4. If the Taxpayer takes the corrective actions described above, and assuming compliance by

the Commission with this methodology on a prospective basis, sanctions for violation of the deferred tax normalization requirements involving disallowance of accelerated depreciation do not apply as a result of the methodology employed.

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

Office of the Associate Chief Counsel

(Passthroughs & Special Industries)

1 We note that, because Taxpayer is using estimated data for the test period, the test period at issue here constitutes a "future test period" under the first interpretation discussed above as well.

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Private Letter Ruling 201531012, 07/31/2015, IRC Sec(s). 167

UIL No. 167.22-01

Depreciation-accelerated cost recovery system-compuation of average rate base-accumulated deferred taxes-normalization rules-consistency requirements.

Headnote:

Independent transmission utility's computation of average rate base with reference to 13-month average for plant and accumulated depreciation for given service year and simple average of beginning and end of year balances for accumulated deferred taxes for same service year complied with **Code Sec. 168(i)(9)(B);** 's consistency requirements of normalization rules for accelerated depreciation.

Reference(s): **Code Sec. 167; Code Sec. 168;**

Full Text:

Number: **201531012**

Release Date: 7/31/2015

Index Number: 167.22-01

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-140122-14

Date:

April 15, 2015

LEGEND:

Taxpayer =

Parent =

State A =

State B =

State C =

State D =

Commission =

Date A =

Director =

Dear [Redacted Text]:

This letter responds to Parent's request, made on behalf of Taxpayer, dated October 23, 2014, for a ruling on the consequences under the normalization provisions of Taxpayer's use of the Commission-approved formula rates as described below.

The representations set out in your letter follow.

Taxpayer, a single member limited liability company, is an independent transmission utility engaged in the transmission of electricity and operates a high-voltage system in States A, B, C, and D. It is subject to regulation by Commission with respect to terms and conditions of services, including the rates it may charge for its services. Taxpayer uses Commission-approved formula rates that are set annually.

The formula uses a cost-of-service model. On Date A of each year, Taxpayer estimates its revenue requirement for the following calendar year, the service year, based in part on the facilities in service at that time or expected to be placed in service during that year. This estimate of Taxpayer's revenue requirement and a Commission-approved rate of return are entered into the template for the formula to calculate the rates. The rates for that calendar year are determined under that formula approved by Commission and go into effect on January 1 of the following calendar year with no additional action by Commission.

In calculating its net annual revenue requirement for the formula, Taxpayer calculates average rate base. All elements of average rate base are calculated using the same test period, the service year. Taxpayer reduces its gross rate base by the average accumulated deferred income taxes. When Taxpayer estimates accumulated deferred income taxes for purposes of estimating it's revenue requirement for the service year, Taxpayer does not use the proration formula required for future test periods by  section 1.167(l)-1(h)(6) of the Income Tax Regulations. Average rate base is computed using monthly averages for plant balances, including accumulated depreciation. For this purpose, depreciation begins when the asset is placed in service. Certain other elements of average rate base, such as land held for future use, materials and supplies, prepayments, and accumulated deferred income taxes are calculated using an average of the beginning and end of year balances. In both cases, the averages are calculated in accordance with the provisions of the Commission-approved template.

The formula rate template contains a "true-up" mechanism under which the Taxpayer compares its actual revenue requirement to its actually-billed revenues for the service year. If billed revenue is greater than the actual revenue requirement for the service year the over-collection is refunded in customer bills within two years of the service year; if billed revenue is less than the actual revenue requirement for the service year the under-collection is collected two years after the service year. For both under and over collections, a carrying charge equivalent to Commission's standard refund interest rate is imposed.

Commission at all times has required that all public utilities under its jurisdiction use normalized methods of accounting.

Taxpayer requests that we rule as follows:

> 1. The computation of average rate base by Taxpayer with reference to 13-month average for plant and accumulated depreciation for a given service year and a simple average of the beginning- and end-of-year balances for accumulated deferred income taxes for the same

service year complies with the consistency requirement of the normalization rules for accelerated depreciation under section 168(i)(9)(B) of the Internal Revenue Code.

2. In the event that the Service does not agree with the Taxpayer's conclusion regarding the first issue, Taxpayer's historical use of the averaging methodology described above is nevertheless not inconsistent with the requirements of § 168(i)(9)(B) and therefore the sanctions for violation of the deferred tax normalization requirements involving disallowance of accelerated depreciation do not apply to Taxpayer as a result of its use of the historical averaging methodology employed.

3. The computation by Taxpayer of accumulated deferred income taxes for purposes of calculating average rate base without application of the rules for future test periods under § 1.167(l)-1(h)(6) involving the proration formula complies with the normalization requirements of § 168(i)(9).

4. In the event that the Service does not agree with the Taxpayer's conclusion regarding Issue 2, sanctions for violation of the deferred tax normalization requirements involving disallowance of accelerated depreciation do not apply as a result of the methodology employed.

Law and Analysis

Issues 1 and 2

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 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) requires that a taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is 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.

In order to satisfy the requirements of §168(i)(9)(B), there must be consistency in the treatment of costs for rate base, regulated depreciation expense, tax expense, and deferred tax revenue purposes. Here, rate base, depreciation expense, and accumulated deferred income taxes are all calculated in consistent fashion - all are averaged over the same period. While there are minor differences in the convention used to average all elements of rate base including depreciation expense on the one hand, and accumulated deferred income taxes on the other, for purposes of §168(i)(9)(B), it is sufficient that both are determined by averaging and both are determined over the same period of time. Thus, the calculation of average rate base and accumulated deferred income taxes as described above complies with the consistency requirement of §168(i)(9)(B).

Because of the conclusion reached above, Taxpayer's second issue is moot and will not be considered further.

Issue 3

Section 1.167(l)-1(h)(6) sets forth additional normalization requirements with respect to public utility

property. Under § 1.167(l)-1(h)(6)(i), a taxpayer does not use a normalization method of accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes excluded from the rate base, or treated as cost-free capital, exceeds the amount of the reserve for the period used in determining the taxpayer's ratemaking tax expense. Section 1.167(l)-1(h)(6)(ii) also provides the procedure for determining the amount of the reserve for deferred taxes to be excluded from rate base or to be included as no-cost capital. If, in determining depreciation for ratemaking tax expense, a period (the "test period") is used which is part historical and part future, then the amount of the reserve account for this period is the amount of the reserve at the end of the historical portion of the period and a pro rata amount of any projected increase to be credited to the account during the future portion of the period. The pro rata amount of any increase during the future portion of the period is determined by multiplying the increase by a fraction, the numerator of which is the number of days remaining in the period at the time the increase is to accrue, and the denominator of which is the total number of days in the future portion of the period.

Section 1.167(l)-1(h)(6)(i) makes it clear that the reserve excluded from rate base must be determined by reference to the same period as is used in determining ratemaking tax expense. A taxpayer may use either historical data or projected data in calculating these two amounts, but it must be consistent. As explained in section 1.167(l)-1(a)(1), the rules provided in section 1.167(l)-1(h)(6)(i) are to insure that the same time period is used to determine the deferred tax reserve amount resulting from the use of an accelerated method of depreciation for cost of service purposes and the reserve amount that may be excluded from the rate base or included in no-cost capital in determining such cost of services.

If a taxpayer chooses to compute its ratemaking tax expense and rate base exclusion amount using projected data then it must use the formula provided in section 1.167(l)-1(h)(6)(ii) to calculate the amount of deferred taxes subject to exclusion from the rate base. This formula prorates the projected accruals to the reserve so as to account for the actual time these amounts are expected to be in the reserve. As explained in § 1.167(l)-1(a)(1), the formula in section 1.167(l)-1(h)(6)(ii) provides a method to determine the period of time during which the taxpayer will be treated as having received amounts credited or charged to the reserve account so that the disallowance of earnings with respect to such amounts through rate base exclusion or treatment as no-cost capital will take into account the factor of time for which such amounts are held by the taxpayer.

The purpose of the proration formula is the same as that of the requirement for consistent periods discussed above: to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers. The proration formula stops flow-through by limiting the deferred tax reserve accruals that may be excluded from rate base, and thus the earnings on rate base that may be disallowed, according to the length of time these accruals are actually in the reserve account.

The effectiveness of § 1.167(l)-1(h)(6)(ii) in resolving the timing issue has been limited by its failure to define some key terms. Nowhere does this provision state what is meant by the terms "historical" and "future" in relation to the period for determining depreciation for ratemaking tax expense (the "test period"). How are these time periods to be measured? One interpretation focuses on the type or quality of the data used in the ratemaking process. According to this interpretation, the historical period is that portion of the test period for which actual data is used, while the portion of the period for which data is estimated is the future period. The second interpretation focuses on when the utility rates become effective. Under this interpretation, the historical period is that portion of the test period before rates go into effect, while the portion of the test period after the effective date of the rate order is the future period.

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In contrast, the second interpretation of section 1.167(l)-1(h)(6)(ii) of the regulations is consistent with the purpose of normalization, which is to preserve for regulated utilities the benefits of accelerated depreciation as a source of cost-free capital. The availability of this capital is ensured by prohibiting flow-through. But whether or not flow-through can even be accomplished by means of rate base exclusions depends primarily on whether, at the time rates become effective, the amounts originally projected to accrue to the deferred tax reserve have actually accrued.

If rates go into effect before the end of the test period, and the rate base reduction is not prorated, the utility commission is denying a current return for accelerated depreciation benefits the utility is only projected to have. This procedure is a form of flow-through, for current rates are reduced to reflect the capital cost savings of accelerated depreciation deductions not yet claimed or accrued by the utility. Yet projected data is often necessary in determining rates, since historical data by itself is rarely an accurate indication of future utility operating results. Thus, the regulations provide that as long as the portion of the deferred tax reserve based on truly projected (future estimated) data is prorated according to the formula in section 1.167(l)-1(h)(6)(ii), a regulator may deduct this reserve from rate base in determining a utility's allowable return. In other words, a utility regulator using projected data in computing ratemaking tax expense and rate base exclusion must account for the passage of time if it is

to avoid flow-through.

But if rates go into effect after the end of the test period, the opportunity to flow through the benefits of future accelerated depreciation to current ratepayers is gone, and so too is the need to apply the proration formula. In this situation, the only question that is important for the purpose of rate base exclusion is the amount in the deferred tax reserve, whether actual or estimated. Once the future period, the period over which accruals to the reserve were projected, is no longer future, the question of when the amounts in the reserve accrued is no longer relevant (at the time the new rate order takes effect, the projected increases have accrued, and the amounts to be excluded from rate base are no longer projected but historical, even though based on estimates).

Taxpayer uses formula rates with the elements determined by estimates of the various elements being averaged as discussed above. Rates go into effect as of the beginning of the service year. **1** As such, the rates are in effect during the test year and the proration formula must be used. The addition of the true up increases the ultimate accuracy of the rates but does not convert a future test period into a historical test period as those terms are used in the normalization regulations. Therefore, Taxpayer is required to apply the proration formula in calculating accumulated deferred income taxes for purposes of calculating rate base.

Issue 4

Because the Service has ruled in Issue 3 that Taxpayer's use of formula rates with true-up adjustments with carrying charges mandates use of the proration formula applicable to future test periods for the projected revenue requirement, prospectively adhering to the Service's interpretation of § 1.167(l)-1(h)(6)(ii) may require Taxpayer to seek and obtain an order from Commission to make the necessary changes to the rate templates, not simply unilaterally adjusting the calculations (or the manner in which the templates are completed) in the next annual projections or true-up adjustments. If Taxpayer must request these changes through a filing with Commission, Taxpayer has represented that, in the event of an adverse conclusion with respect to Issue 3 by the Service, it will make a filing with Commission to amend its formula rate template within six months of receipt of this ruling letter, requesting that Commission apply a methodology in accordance with this letter using an effective date of the first month following the date of the filing made with Commission. Following Commission's order in that filing, Taxpayer will prospectively apply the methodology consistent with this letter approved by Commission. Until Commission acts on the filing, Taxpayer will continue to use the methodology described above.

If Taxpayer determines that it is not required to make a formal filing with Commission to implement the computational changes required by the letter ruling, Taxpayer would reflect the holding of the private letter ruling in its next annual projected revenue requirement filing. For example, assuming that the letter ruling is received in April 2015 indicating that the projected revenue requirement is based solely on a future period and the actual revenue requirement used for the true-up mechanism is based solely on a historical period, Taxpayer would compute its year-end accumulated deferred income tax amount

for its beginning-of-year/end-of-year average of accumulated deferred income taxes based on application of the proration formula to the monthly net increases or decreases to its accumulated deferred income taxes for annual projected revenue requirement filings after receipt of the private letter ruling (i.e., beginning with the filing due September 1, 2015, for the calendar-year 2016 test year and service period).

 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. However, in the legislative history to the enactment of the normalization requirements of the Investment Tax Credit, Congress has stated that it hopes that sanctions will not have to be imposed and that disallowance of the tax benefit (there, the ITC) should be imposed only after a regulatory body has required or insisted upon such treatment by a utility. See Senate Report No. 92-437, 92nd Cong., 1st Sess. 40-41 (1971), 1972-2 C.B. 559, 581.

Here, Taxpayer has used a template approved by Commission to calculate formula-based rates. Commission has, at all times, required that utilities under its jurisdiction use normalization methods of accounting. Taxpayer also intended at all times to comply with the normalization rules. However, Taxpayer concluded that the use of the true-up would allow the entirety of the rate calculation to be considered a purely historical period and thus not require the application of the proration formula described in  § 1.167(l)-1(h)(6)(ii). As concluded above, this conclusion is not in accord with the normalization rules. However because both Commission and Taxpayer at all times sought to comply, because Taxpayer merely populated a Commission-approved formula template rather than Commission carefully considering the calculation and ordering its use by Taxpayer, and because Taxpayer will take the corrective actions described above, it is not currently appropriate to apply the sanction of denial of accelerated depreciation to Taxpayer.

Conclusions

1. The computation of average rate base by Taxpayer with reference to 13-month average for plant and accumulated depreciation for a given service year and a simple average of the beginning- and end-of-year balances for accumulated deferred income taxes for the same service year complies with the consistency requirement of the normalization rules for accelerated depreciation under  section 168(i)(9)(B) of the Internal Revenue Code.

2. Because of the conclusion reached in Issue 1, Issue 2 is moot.

3. The computation by Taxpayer of accumulated deferred income taxes for purposes of calculating average rate base without application of the rules for future test periods under  § 1.167(l)-1(h)(6) involving the proration formula for its projected revenue requirement does not comply with the normalization requirements of  § 168(i)(9). The computation by

Taxpayer of accumulated deferred income taxes for purposes of calculating average rate base without application of the rules for future test periods under § 1.167(l)-1(h)(6) involving the proration formula for its actual revenue requirement used for the true-up mechanism complies with the normalization requirements of § 168(i)(9).

4. If the Taxpayer takes the corrective actions described above, and assuming compliance by the Commission with this methodology on a prospective basis, sanctions for violation of the deferred tax normalization requirements involving disallowance of accelerated depreciation do not apply as a result of the methodology employed.

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

Office of the Associate Chief Counsel

(Passthroughs & Special Industries)

1 We note that, because Taxpayer is using estimated data for the test period, the test period at issue here constitutes a "future test period" under the first interpretation discussed above as well.

Private Letter Rulings

Private Letter Ruling 201532018, 08/07/2015, IRC Sec(s). 167

UIL No. 167.22-01

Depreciation-accelerated cost recovery system-computation of average rate base-accumulated deferred taxes-normalization rules-consistency requirements.

Headnote:

Independent transmission utility's computation of average rate base with reference to 13-month average for plant and accumulated depreciation for given service year and simple average of beginning and end of year balances for accumulated deferred taxes for same service year complied with **Code Sec. 168(i)(9)(B);** 's consistency requirements of normalization rules for accelerated depreciation.

Reference(s): **Code Sec. 167; Code Sec. 168;**

Full Text:

Number: **201532018**

Release Date: 8/7/2015

Index Number: 167.22-01

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-140117-14

Date :April 15, 2015

LEGEND

Taxpayer =

Parent =

State A =

State B =

Commission =

Date A =

Director =

Dear [Redacted Text]:

This letter responds to Parent's request, made on behalf of Taxpayer, dated October 23, 2014, for a ruling on the consequences under the normalization provisions of Taxpayer's use of the Commission-approved formula rates as described below.

The representations set out in your letter follow.

Taxpayer, a single member limited liability company, is an independent transmission utility engaged in the transmission of electricity and operates a high-voltage system in States A and B. It is subject to regulation by Commission with respect to terms and conditions of services, including the rates it may

charge for its services. Taxpayer uses Commission-approved formula rates that are set annually. The formula uses a cost-of-service model. On Date A of each year, Taxpayer estimates its revenue requirement for the following calendar year, the service year, based in part on the facilities in service at that time or expected to be placed in service during that year. This estimate of Taxpayer's revenue requirement and a Commission-approved rate of return are entered into the template for the formula to calculate the rates. The rates for that calendar year are determined under that formula approved by Commission and go into effect on January 1 of the following calendar year with no additional action by Commission.

In calculating its net annual revenue requirement for the formula, Taxpayer calculates average rate base. All elements of average rate base are calculated using the same test period, the service year. Taxpayer reduces its gross rate base by the average accumulated deferred income taxes. When Taxpayer estimates accumulated deferred income taxes for purposes of estimating it's revenue requirement for the service year, Taxpayer does not use the proration formula required for future test periods by  section 1.167(l)-1(h)(6) of the Income Tax Regulations. Average rate base is computed using monthly averages for plant balances, including accumulated depreciation. For this purpose, depreciation begins when the asset is placed in service. Certain other elements of average rate base, such as land held for future use, materials and supplies, prepayments, and accumulated deferred income taxes are calculated using an average of the beginning and end of year balances. In both cases, the averages are calculated in accordance with the provisions of the Commission-approved template.

The formula rate template contains a "true-up" mechanism under which the Taxpayer compares its actual revenue requirement to its actually-billed revenues for the service year. If billed revenue is greater than the actual revenue requirement for the service year the over-collection is refunded in customer bills within two years of the service year; if billed revenue is less than the actual revenue requirement for the service year the under-collection is collected two years after the service year. For both under and over collections, a carrying charge equivalent to Commission's standard refund interest rate is imposed.

Commission at all times has required that all public utilities under its jurisdiction use normalized methods of accounting.

Taxpayer requests that we rule as follows:

1. The computation of average rate base by Taxpayer with reference to 13-month average for plant and accumulated depreciation for a given service year and a simple average of the beginning- and end-of-year balances for accumulated deferred income taxes for the same service year complies with the consistency requirement of the normalization rules for accelerated depreciation under  section 168(i)(9)(B) of the Internal Revenue Code.

2. In the event that the Service does not agree with the Taxpayer's conclusion regarding the

first issue, Taxpayer's historical use of the averaging methodology described above is nevertheless not inconsistent with the requirements of § 168(i)(9)(B) and therefore the sanctions for violation of the deferred tax normalization requirements involving disallowance of accelerated depreciation do not apply to Taxpayer as a result of its use of the historical averaging methodology employed.

3. The computation by Taxpayer of accumulated deferred income taxes for purposes of calculating average rate base without application of the rules for future test periods under § 1.167(l)-1(h)(6) involving the proration formula complies with the normalization requirements of § 168(i)(9).

4. In the event that the Service does not agree with the Taxpayer's conclusion regarding Issue 2, sanctions for violation of the deferred tax normalization requirements involving disallowance of accelerated depreciation do not apply as a result of the methodology employed.

Law and Analysis

Issues 1 and 2

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 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) requires that a taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes of establishing

its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is 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.

In order to satisfy the requirements of §168(i)(9)(B), there must be consistency in the treatment of costs for rate base, regulated depreciation expense, tax expense, and deferred tax revenue purposes. Here, rate base, depreciation expense, and accumulated deferred income taxes are all calculated in consistent fashion - all are averaged over the same period. While there are minor differences in the convention used to average all elements of rate base including depreciation expense on the one hand, and accumulated deferred income taxes on the other, for purposes of §168(i)(9)(B), it is sufficient that both are determined by averaging and both are determined over the same period of time. Thus, the calculation of average rate base and accumulated deferred income taxes as described above complies with the consistency requirement of §168(i)(9)(B).

Because of the conclusion reached above, Taxpayer's second issue is moot and will not be considered further.

Issue 3

Section 1.167(l)-1(h)(6) sets forth additional normalization requirements with respect to public utility property. Under § 1.167(l)-1(h)(6)(i), a taxpayer does not use a normalization method of accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes excluded from the rate base, or treated as cost-free capital, exceeds the amount of the reserve for the period used in determining the

taxpayer's ratemaking tax expense. Section 1.167(l)-1(h)(6)(ii) also provides the procedure for determining the amount of the reserve for deferred taxes to be excluded from rate base or to be included as no-cost capital. If, in determining depreciation for ratemaking tax expense, a period (the "test period") is used which is part historical and part future, then the amount of the reserve account for this period is the amount of the reserve at the end of the historical portion of the period and a pro rata amount of any projected increase to be credited to the account during the future portion of the period. The pro rata amount of any increase during the future portion of the period is determined by multiplying the increase by a fraction, the numerator of which is the number of days remaining in the period at the time the increase is to accrue, and the denominator of which is the total number of days in the future portion of the period.

Section 1.167(l)-1(h)(6)(i) makes it clear that the reserve excluded from rate base must be determined by reference to the same period as is used in determining ratemaking tax expense. A taxpayer may use either historical data or projected data in calculating these two amounts, but it must be consistent. As explained in section 1.167(l)-1(a)(1), the rules provided in section 1.167(l)-1(h)(6)(i) are to insure that the same time period is used to determine the deferred tax reserve amount resulting from the use of an accelerated method of depreciation for cost of service purposes and the reserve amount that may be excluded from the rate base or included in no-cost capital in determining such cost of services.

If a taxpayer chooses to compute its ratemaking tax expense and rate base exclusion amount using projected data then it must use the formula provided in section 1.167(l)-1(h)(6)(ii) to calculate the amount of deferred taxes subject to exclusion from the rate base. This formula prorates the projected accruals to the reserve so as to account for the actual time these amounts are expected to be in the reserve. As explained in § 1.167(l)-1(a)(1), the formula in section 1.167(l)-1(h)(6)(ii) provides a method to determine the period of time during which the taxpayer will be treated as having received amounts credited or charged to the reserve account so that the disallowance of earnings with respect to such amounts through rate base exclusion or treatment as no-cost capital will take into account the factor of time for which such amounts are held by the taxpayer.

The purpose of the proration formula is the same as that of the requirement for consistent periods discussed above: to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers. The proration formula stops flow-through by limiting the deferred tax reserve accruals that may be excluded from rate base, and thus the earnings on rate base that may be disallowed, according to the length of time these accruals are actually in the reserve account.

The effectiveness of § 1.167(l)-1(h)(6)(ii) in resolving the timing issue has been limited by its failure to define some key terms. Nowhere does this provision state what is meant by the terms "historical" and "future" in relation to the period for determining depreciation for ratemaking tax expense (the "test

period"). How are these time periods to be measured ? One interpretation focuses on the type or quality of the data used in the ratemaking process. According to this interpretation, the historical period is that portion of the test period for which actual data is used, while the portion of the period for which data is estimated is the future period. The second interpretation focuses on when the utility rates become effective. Under this interpretation, the historical period is that portion of the test period before rates go into effect, while the portion of the test period after the effective date of the rate order is the future period.

The first interpretation, which focuses on the quality of the ratemaking data, is an attractive one. It proposes a simple rule, easy to follow and to enforce: any portion of the reserve for deferred taxes based on estimated data must be prorated in determining the amount to be deducted from rate base. The actual passage of time between the date ratemaking data is submitted and the date rates become effective is of no importance. But this interpretation of the regulations achieves simplicity at the expense of precision; in other words, it is overbroad. The proration of all estimated deferred tax data does serve to magnify the benefits of accelerated depreciation to the utility, but this is not the purpose of normalization. Congress was explicit: normalization "in no way diminishes whatever power the [utility regulatory] agency may have to require that the deferred taxes reserve be excluded from the base upon which the utility's permitted rate of return is calculated." H.R. Rep. No. 413, 91st Cong., 1st Sess. 133 (1969). In contrast, the second interpretation of section 1.167(l)-1(h)(6)(ii) of the regulations is consistent with the purpose of normalization, which is to preserve for regulated utilities the benefits of accelerated depreciation as a source of cost-free capital. The availability of this capital is ensured by prohibiting flow-through. But whether or not flow-through can even be accomplished by means of rate base exclusions depends primarily on whether, at the time rates become effective, the amounts originally projected to accrue to the deferred tax reserve have actually accrued.

If rates go into effect before the end of the test period, and the rate base reduction is not prorated, the utility commission is denying a current return for accelerated depreciation benefits the utility is only projected to have. This procedure is a form of flow-through, for current rates are reduced to reflect the capital cost savings of accelerated depreciation deductions not yet claimed or accrued by the utility. Yet projected data is often necessary in determining rates, since historical data by itself is rarely an accurate indication of future utility operating results. Thus, the regulations provide that as long as the portion of the deferred tax reserve based on truly projected (future estimated) data is prorated according to the formula in section 1.167(l)-1(h)(6)(ii), a regulator may deduct this reserve from rate base in determining a utility's allowable return. In other words, a utility regulator using projected data in computing ratemaking tax expense and rate base exclusion must account for the passage of time if it is to avoid flow-through.

But if rates go into effect after the end of the test period, the opportunity to flow through the benefits of future accelerated depreciation to current ratepayers is gone, and so too is the need to apply the proration formula. In this situation, the only question that is important for the purpose of rate base exclusion is the amount in the deferred tax reserve, whether actual or estimated. Once the future

period, the period over which accruals to the reserve were projected, is no longer future, the question of when the amounts in the reserve accrued is no longer relevant (at the time the new rate order takes effect, the projected increases have accrued, and the amounts to be excluded from rate base are no longer projected but historical, even though based on estimates).

Taxpayer uses formula rates with the elements determined by estimates of the various elements being averaged as discussed above. Rates go into effect as of the beginning of the service year. **1** As such, the rates are in effect during the test year and the proration formula must be used. The addition of the true up increases the ultimate accuracy of the rates but does not convert a future test period into a historical test period as those terms are used in the normalization regulations. Therefore, Taxpayer is required to apply the proration formula in calculating accumulated deferred income taxes for purposes of calculating rate base.

Issue 4

Because the Service has ruled in Issue 3 that Taxpayer's use of formula rates with true-up adjustments with carrying charges mandates use of the proration formula applicable to future test periods for the projected revenue requirement, prospectively adhering to the Service's interpretation of § 1.167(l)-1(h)(6)(ii) may require Taxpayer to seek and obtain an order from Commission to make the necessary changes to the rate templates, not simply unilaterally adjusting the calculations (or the manner in which the templates are completed) in the next annual projections or true-up adjustments. If Taxpayer must request these changes through a filing with Commission, Taxpayer has represented that, in the event of an adverse conclusion with respect to Issue 3 by the Service, it will make a filing with Commission to amend its formula rate template within six months of receipt of this ruling letter, requesting that Commission apply a methodology in accordance with this letter using an effective date of the first month following the date of the filing made with Commission. Following Commission's order in that filing, Taxpayer will prospectively apply the methodology consistent with this letter approved by Commission. Until Commission acts on the filing, Taxpayer will continue to use the methodology described above.

If Taxpayer determines that it is not required to make a formal filing with Commission to implement the computational changes required by the letter ruling, Taxpayer would reflect the holding of the private letter ruling in its next annual projected revenue requirement filing. For example, assuming that the letter ruling is received in April 2015 indicating that the projected revenue requirement is based solely on a future period and the actual revenue requirement used for the true-up mechanism is based solely on a historical period, Taxpayer would compute its year-end accumulated deferred income tax amount for its beginning-of-year/end-of-year average of accumulated deferred income taxes based on application of the proration formula to the monthly net increases or decreases to its accumulated deferred income taxes for annual projected revenue requirement filings after receipt of the private letter ruling (i.e., beginning with the filing due September 1, 2015, for the calendar-year 2016 test year and service period).

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. However, in the legislative history to the enactment of the normalization requirements of the Investment Tax Credit, Congress has stated that it hopes that sanctions will not have to be imposed and that disallowance of the tax benefit (there, the ITC) should be imposed only after a regulatory body has required or insisted upon such treatment by a utility. See Senate Report No. 92-437, 92nd Cong., 1st Sess. 40-41 (1971), 1972-2 C.B. 559, 581.

Here, Taxpayer has used a template approved by Commission to calculate formula-based rates. Commission has, at all times, required that utilities under its jurisdiction use normalization methods of accounting. Taxpayer also intended at all times to comply with the normalization rules. However, Taxpayer concluded that the use of the true-up would allow the entirety of the rate calculation to be considered a purely historical period and thus not require the application of the proration formula described in § 1.167(l)-1(h)(6)(ii). As concluded above, this conclusion is not in accord with the normalization rules. However because both Commission and Taxpayer at all times sought to comply, because Taxpayer merely populated a Commission-approved formula template rather than Commission carefully considering the calculation and ordering its use by Taxpayer, and because Taxpayer will take the corrective actions described above, it is not currently appropriate to apply the sanction of denial of accelerated depreciation to Taxpayer.

Conclusions

1. The computation of average rate base by Taxpayer with reference to 13-month average for plant and accumulated depreciation for a given service year and a simple average of the beginning- and end-of-year balances for accumulated deferred income taxes for the same service year complies with the consistency requirement of the normalization rules for accelerated depreciation under section 168(i)(9)(B) of the Internal Revenue Code.

2. Because of the conclusion reached in Issue 1, Issue 2 is moot.

3. The computation by Taxpayer of accumulated deferred income taxes for purposes of calculating average rate base without application of the rules for future test periods under § 1.167(l)-1(h)(6) involving the proration formula for its projected revenue requirement does not comply with the normalization requirements of § 168(i)(9). The computation by Taxpayer of accumulated deferred income taxes for purposes of calculating average rate base without application of the rules for future test periods under § 1.167(l)-1(h)(6) involving the proration formula for its actual revenue requirement used for the true-up mechanism complies with the normalization requirements of § 168(i)(9).

4. If the Taxpayer takes the corrective actions described above, and assuming compliance by the Commission with this methodology on a prospective basis, sanctions for violation of the deferred tax normalization requirements involving disallowance of accelerated depreciation do not apply as a result of the methodology employed.

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

Office of the Associate Chief Counsel

(Passthroughs & Special Industries)

cc: [Redacted Text]

1 We note that, because Taxpayer is using estimated data for the test period, the test period at issue here constitutes a "future test period" under the first interpretation discussed above as well.

Internal Revenue Service

Number: **201541010**
Release Date: 10/9/2015

Index Number: 167.22-01

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B06
PLR-143241-14

Date:
July 06, 2015

LEGEND:

Taxpayer	=
Parent	=
State A	=
State B	=
Commission A	=
Commission B	=
Commission C	=
Operator	=
Year A	=
Case A	=
Case B	=
Case C	=
Date X	=
Director	=

Dear :

This letter responds to Parent's request, made on behalf of Taxpayer, dated January 9, 2015, for a ruling on the application of the normalization rules to certain regulatory procedures applied in State as described below.

The representations set out in your letter follow.

Taxpayer, a wholly-owned subsidiary of Parent, is primarily engaged in the business of generating, transmitting, distributing, and selling electric power to customers in State A and State B. It is subject to regulation by Commission A, Commission B, and Commission C with respect to terms and conditions of services, including the rates it may charge for its services. All three Commissions establish Taxpayer's rates based on Taxpayer's costs, including a provision for a return on the capital employed by Taxpayer in its regulated business.

The law of State A provides a process under which a utility may recover its costs relating to projects such as new electric generation facilities as a stand-alone rate adjustment added to customers' base rates. As relevant to this ruling request, the process for setting the rates involves two components. First, a taxpayer files estimated projections of all factors, including Accumulated Deferred Federal Income Taxes (ADFIT), relevant to the costs associated with the facility that is the subject of the rate adjustment. Rate base for this purpose is calculated using an average of the thirteen projected end of month balances of the components of rate base. The rate adjustment computed using these projections goes into effect at the beginning of the test period. The test period is a twelve month period. The anticipated collections from rate payers, the actual cost incurred with respect to the generating facility and any differences between anticipated amounts and actual amounts are reconciled by a "true-up" mechanism at the end of the test year. Under this mechanism, the reconciliation amount is either charged to ratepayers (if actual revenues are below estimates) or credited to ratepayers (if actual revenues exceed estimates) as part of the rates established for the forthcoming rate year. For both under and over collections, a carrying charge is imposed.

Taxpayer owns and operates electric transmission lines in several states, including State A and State B. These lines are integrated into Operator, a regional transmission operator. The rates that Taxpayer may charge its customers for these transmission services are set using a formula approved by Commission C. The formula rates are calculated using a methodology similar to that used to calculate the rate adjustments, inasmuch as the formula rates are calculated using projected costs to establish rates during the period for which rates are being set and a true-up based on over or under recoveries that are reflected in a subsequent rate year. The rates are determined by application of the formula approved by Commission C and go into effect with no additional action by Commission C.

Taxpayer claims accelerated depreciation on its tax returns to the extent permitted by the Internal Revenue Code. Taxpayer normalizes the federal income taxes deferred as a result of its use of accelerated depreciation and thus maintains an ADFIT balance on its regulatory books. In ratemaking proceedings before Commission A to authorize rate adjustments as well as in calculation of the formula rates, rate base is reduced by the calculated ADFIT balance. In calculating its ADFIT balance for purposes of both the projection and true-up elements of the rate adjustment

calculations, Taxpayer followed the same averaging conventions it used for the other components of rate base. However, for prior formula rate filings, Taxpayer had calculated its ADFIT balance by an average of the beginning and ending balances notwithstanding that it used a 13-month average for computation of the plant portion of rate base. In those prior cases, the averages are calculated in accordance with the provisions of the Commission-approved template and the differences in averaging conventions are required by the regulations adopted by Commission C.

Section 1.167(l)-1(h)(6) of the Income Tax Regulations requires that a proration methodology be used by Taxpayer to calculate its applicable ADFIT balance for future test periods. Prior to Year A, Taxpayer had not used the proration methodology either in estimating its projected ADFIT balance or for the calculation of ADFIT for purposes of the true-up. Members of Taxpayer's tax department became concerned about the normalization implications of not using the proration formula during Year A. In filing Case A, Case B, and Case C, Taxpayer incorporated the proration methodology into the calculation of its projected ADFIT balance. In addition, Taxpayer incorporated the proration methodology into the calculation of the true-up in Case B. The staff of Commission A did not agree that the test period used for the rate adjustment ratemaking was a future test period and therefore asserted that the proration methodology was not required. In each of these cases, Commission A approved the use of the proration methodology in the projected ADFIT balance but denied its use in the true-up. When Commission A approved the use of the proration methodology for the projected ADFIT balance, it revised a portion of the Taxpayer's cash working capital allowance to reflect the adoption of the proration methodology. The adjusted portion was intended to compensate Taxpayer for the lag in time between when expenditures are made for services by Taxpayer and when collections for those services are received by Taxpayer. Commission A concluded that the item in the cash working capital allowance was duplicative of the effect of the proration methodology and was thus unnecessary. Due to the uncertainty surrounding the application of the proration methodology and the adjustment to cash working capital, Commission A directed Taxpayer to seek this ruling from the Internal Revenue Service.

Both Commission A and Commission C at all times have required that all public utilities under their respective jurisdictions use normalized methods of accounting.

Taxpayer requests that we rule as follows:

1. The proration methodology requirement does not apply to stand-alone rate adjustment ratemaking and to the Commission C formula rates even if they involve future test periods.
2. The estimated projection component of both the stand-alone rate adjustment ratemaking and the formula rate does not employ a future test period within the meaning of § 1.167(l)-1(h)(6)(ii) and therefore Taxpayer is not required to use the proration methodology in order to comply with the normalization rules.

3. The true-up component of both the stand-alone rate adjustment ratemaking and the formula rate does not employ a future test period within the meaning of § 1.167(l)-1(h)(6)(ii) and therefore Taxpayer is not required to use the proration methodology in order to comply with the normalization rules.
4. In Taxpayer's stand-alone rate adjustment proceedings, an adjustment to eliminate from the Taxpayer's cash working capital allowance any provision for accelerated depreciation-related ADFIT if the proration methodology is employed does not conflict with the normalization rules.
5. In order to comply with the consistency requirement of the normalization rules, it is not necessary that the Taxpayer use the same averaging convention it uses in computing the other elements of rate base in computing its ADFIT balance for purposes of the formula rates.
6. If the Service rules adversely with respect to Rulings 1, 2, or 3, above, any failure by Taxpayer to employ the proration methodology prior to the proceedings in Cases A, B, or C or the effective date approved by Commission C for the requested modification of the formula rates was not a violation of the normalization rules requiring sanctions for such violation.
7. In the event that the Service rules adversely with respect to Ruling 5, above, Taxpayer's failure to comply with the consistency requirement in connection with its formula rates prior to the effective date approved by Commission C for the requested modification of the formula rates was not a violation of the normalization rules.

Law and Analysis

Issues 1 and 2

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 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) requires that a taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is 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 1.167(l)-1(h)(6) sets forth additional normalization requirements with respect to public utility property. Under § 1.167(l)-1(h)(6)(i), a taxpayer does not use a normalization method of accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes excluded from the rate base, or treated as cost-free capital, exceeds the amount of the reserve for the period used in determining the taxpayer's ratemaking tax expense. Section 1.167(l)-1(h)(6)(ii) also provides the procedure for determining the amount of the reserve for deferred taxes to be excluded from rate base or to be included as no-cost capital. If, in determining depreciation for ratemaking tax expense, a period (the "test period") is used which is part historical and part future, then the amount of the reserve account for this period is the amount of the reserve at the end of the historical portion of the period and a pro rata amount of any projected increase to be credited to the account during the future portion of the period. The pro rata amount of any increase during the future portion of the period is determined by multiplying the increase by a fraction, the numerator of which is the number of days remaining in the period at the time the increase is to accrue, and the denominator of which is the total number of days in the future portion of the period.

Section 1.167(l)-1(h)(6)(i) makes it clear that the reserve excluded from rate base must be determined by reference to the same period as is used in determining ratemaking tax expense. A taxpayer may use either historical data or projected data in calculating these two amounts, but it must be consistent. As explained in section 1.167(l)-1(a)(1), the rules provided in section 1.167(l)-1(h)(6)(i) are to insure that the same time period is used to determine the deferred tax reserve amount resulting from the use of an accelerated method of depreciation for cost of service purposes and the reserve amount that may be excluded from the rate base or included in no-cost capital in determining such cost of services.

If a taxpayer chooses to compute its ratemaking tax expense and rate base

exclusion amount using projected data then it must use the formula provided in section 1.167(l)-1(h)(6)(ii) to calculate the amount of deferred taxes subject to exclusion from the rate base. This formula prorates the projected accruals to the reserve so as to account for the actual time these amounts are expected to be in the reserve. As explained in § 1.167(l)-1(a)(1), the formula in section 1.167(l)-1(h)(6)(ii) provides a method to determine the period of time during which the taxpayer will be treated as having received amounts credited or charged to the reserve account so that the disallowance of earnings with respect to such amounts through rate base exclusion or treatment as no-cost capital will take into account the factor of time for which such amounts are held by the taxpayer.

The purpose of the proration formula is to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers. The proration formula stops flow-through by limiting the deferred tax reserve accruals that may be excluded from rate base, and thus the earnings on rate base that may be disallowed, according to the length of time these accruals are actually in the reserve account.

The effectiveness of § 1.167(l)-1(h)(6)(ii) in resolving the timing issue has been questioned by its failure to define some key terms. Nowhere does this provision state what is meant by the terms "historical" and "future" in relation to the period for determining depreciation for ratemaking tax expense (the "test period"). One interpretation focuses on the type or quality of the data used in the ratemaking process. According to this interpretation, the historical period is that portion of the test period for which actual data is used, while the portion of the period for which data is estimated is the future period. The second interpretation focuses on when the utility rates become effective. Under this interpretation, the historical period is that portion of the test period before rates go into effect, while the portion of the test period after the effective date of the rate order is the future period.

The first interpretation, which focuses on the quality of the ratemaking data, is an attractive one. It proposes a simple rule, easy to follow and to enforce: any portion of the reserve for deferred taxes based on estimated data must be prorated in determining the amount to be deducted from rate base. The actual passage of time between the date ratemaking data is submitted and the date rates become effective is of no importance. But this interpretation of the regulations achieves simplicity at the expense of precision; in other words, it is overbroad. The proration of all estimated deferred tax data does serve to magnify the benefits of accelerated depreciation to the utility, but this is not the purpose of normalization. Congress was explicit: normalization "in no way diminishes whatever power the [utility regulatory] agency may have to require that the deferred taxes reserve be excluded from the base upon which the utility's permitted rate of return is calculated." H.R. Rep. No. 413, 91st Cong., 1st Sess. 133 (1969).

In contrast, the second interpretation of section 1.167(l)-1(h)(6)(ii) of the regulations is consistent with the purpose of normalization, which is to preserve for

regulated utilities the benefits of accelerated depreciation as a source of cost-free capital. The availability of this capital is ensured by prohibiting flow-through. But whether or not flow-through can even be accomplished by means of rate base exclusions depends primarily on whether, at the time rates become effective, the amounts originally projected to accrue to the deferred tax reserve have actually accrued.

If rates go into effect before the end of the test period, and the rate base reduction is not prorated, the utility commission is denying a current return for accelerated depreciation benefits the utility is only projected to have. This procedure is a form of flow-through, for current rates are reduced to reflect the capital cost savings of accelerated depreciation deductions not yet claimed or accrued by the utility. Yet projected data is often necessary in determining rates, since historical data by itself is rarely an accurate indication of future utility operating results. Thus, the regulations provide that as long as the portion of the deferred tax reserve based on projected (future estimated) data is prorated according to the formula in section 1.167(l)-1(h)(6)(ii), a regulator may deduct this reserve from rate base in determining a utility's allowable return. In other words, a utility regulator using projected data in computing ratemaking tax expense and rate base exclusion must account for the passage of time if it is to avoid flow-through.

But if rates go into effect after the end of the test period, the opportunity to flow through the benefits of future accelerated depreciation to current ratepayers is gone, and so too is the need to apply the proration formula. In this situation, the only question that is important for the purpose of rate base exclusion is the amount in the deferred tax reserve, whether actual or estimated. Once the future period, the period over which accruals to the reserve were projected, is no longer future, the question of when the amounts in the reserve accrued is no longer relevant (at the time the new rate order takes effect, the projected increases have accrued, and the amounts to be excluded from rate base are no longer projected but historical, even though based on estimates).

There are two kinds of ratemaking at issue here, with identical components. For both the stand-alone rate adjustment and the formula rates, Taxpayer estimates the various components of rate base. Rates go into effect as of the beginning of the service year.[1] As such, the rates are in effect during the test year and the proration formula must be used. The addition of the true up increases the ultimate accuracy of the rates but does not convert a future test period into a historical test period as those terms are used in the normalization regulations. Therefore, Taxpayer is required to apply the proration formula in calculating accumulated deferred income taxes for purposes of calculating rate base.

Issue 3

[1] We note that, because Taxpayer is using estimated data for the test period, the test period at issue here constitutes a “future test period” under the first interpretation discussed above as well.

As discussed above, where a taxpayer computes its ratemaking tax expense and rate base exclusion amount using projected data then must use the proration formula provided in section 1.167(l)-1(h)(6)(ii) to calculate the amount of deferred taxes subject to exclusion from the rate base. This formula prorates the projected accruals to the reserve so as to account for the actual time these amounts are expected to be in the reserve. As explained in § 1.167(l)-1(a)(1), the formula in section 1.167(l)-1(h)(6)(ii) provides a method to determine the period of time during which the taxpayer will be treated as having received amounts credited or charged to the reserve account so that the disallowance of earnings with respect to such amounts through rate base exclusion or treatment as no-cost capital will take into account the factor of time for which such amounts are held by the taxpayer.

The purpose of the proration formula is to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers. The proration formula stops flow-through by limiting the deferred tax reserve accruals that may be excluded from rate base, and thus the earnings on rate base that may be disallowed, according to the length of time these accruals are actually in the reserve account.

In contrast to the projections discussed above, the true-up component is determined by reference to a purely historical period and there is no need to use the proration formula to calculate the differences between Taxpayer's projected ADFIT balance and the actual ADFIT balance during the period. In calculating the true-up, proration applies to the original projection amount but the actual amount added to the ADFIT over the test year is not modified by application of the proration formula.

Issue 4

In Taxpayer's stand-alone rate adjustment proceedings, Commission A adjusted the already-approved cash working capital allowance specifically to mitigate the effect of the use of the proration methodology, finding the effects duplicative. In general, taxpayers may not adopt any accounting treatment that directly or indirectly circumvents the normalization rules. See generally, § 1.46-6(b)(2)(ii) (In determining whether, or to what extent, the investment tax credit has been used to reduce cost of service, reference shall be made to any accounting treatment that affects cost of service); Rev. Proc 88-12, 1988-1 C.B. 637, 638 (It is a violation of the normalization rules for taxpayers to adopt any accounting treatment that, directly or indirectly flows excess tax reserves to ratepayers prior to the time that the amounts in the vintage accounts reverse). Here, Commission A adjusted the cash working capital allowance specifically to mitigate the effect of the application of the proration methodology. This is inconsistent with the normalization rules. We do not hold that the normalization rules require a similar type of cash working capital adjustment in all cases; we hold only that, where, as here, it is adjusted or removed in an attempt to mitigate the effects of the

application of the proration methodology or similar normalization rule, that adjustment or removal is not permitted under the normalization rules.

Issue 5

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 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) requires that a taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is 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.

In order to satisfy the requirements of §168(i)(9)(B), there must be consistency in the treatment of costs for rate base, regulated depreciation expense, tax expense, and deferred tax revenue purposes. Here, rate base, depreciation expense, and accumulated deferred income taxes are all calculated in consistent fashion – all are averaged over the same period. While there are minor differences in the convention used to average all elements of rate base including depreciation expense on the one hand, and ADFIT on the other, for purposes of §168(i)(9)(B), it is sufficient that both are determined by averaging and both are determined over the same period of time. Thus, the calculation of average rate base and accumulated deferred income taxes as described above complies with the consistency requirement of §168(i)(9)(B).

Because of the conclusion reached above, Taxpayer's seventh issue is moot and will not be considered further.

Issue 6

Because the Service has ruled in Issue 1 and 2 that Taxpayer was required to use the proration formula applicable to future test periods for the projected revenue requirement, prospectively adhering to the Service's interpretation of § 1.167(l)-1(h)(6)(ii) require adjustments to conform to this ruling. Any rates that have been calculated using procedures inconsistent with this ruling ("nonconforming rates") which are or which have been in effect and which, under applicable state or federal regulatory law, can be adjusted or corrected to conform to the requirements of this ruling, must be so adjusted or corrected. Where nonconforming rates cannot be adjusted or corrected to conform to the requirements of this ruling due to the operation of state or federal regulatory law, then such correction must be made in the next regulatory filing or proceeding in which Taxpayer's rates are considered. Specifically, the current timing of Taxpayer's stand-alone rate adjustment filings with Commission A will accommodate all adjustments or corrections to any prior estimated projections or true-ups necessary to conform to the requirements of this ruling in rates having an effective date no later Date X, including Case A, Case B, and Case C. In addition, Taxpayer has already sought an order from Commission C to make the necessary changes to the rate templates, not simply unilaterally adjusting the calculations (or the manner in which the templates are completed) in the next annual projections or true-up adjustments. If Taxpayer must request these changes through a filing with Commission C, Taxpayer has represented that it will make a filing with Commission C to amend its formula rate template within six months of receipt of this ruling letter, requesting that Commission C apply a methodology in accordance with this letter using an effective date of the first month following the date of the filing made with Commission C. Following Commission C's order in that filing, Taxpayer will prospectively apply the methodology consistent with

this letter approved by Commission C. Until Commission C acts on the filing, Taxpayer will continue to use the methodology described above.

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. However, in the legislative history to the enactment of the normalization requirements of the Investment Tax Credit, Congress has stated that it hopes that sanctions will not have to be imposed and that disallowance of the tax benefit (there, the ITC) should be imposed only after a regulatory body has required or insisted upon such treatment by a utility. See Senate Report No. 92-437, 92nd Cong., 1st Sess. 40-41 (1971), 1972-2 C.B. 559, 581.

Here, Taxpayer has received stand-alone rate adjustments from Commission A without application of the proration methodology as required. In addition, Taxpayer used a template approved by Commission C to calculate formula-based rates. Both Commission A and Commission C have, at all times, required that utilities under their respective jurisdictions use normalization methods of accounting. Taxpayer also intended at all times to comply with the normalization rules. As concluded above, Taxpayer was required to use the proration methodology in these ratemaking proceedings. However because Commissions A and C as well as Taxpayer at all times sought to comply, and because Taxpayer will take the corrective actions described above, it is not currently appropriate to apply the sanction of denial of accelerated depreciation to Taxpayer.

Conclusions

1. The proration methodology requirement applies to all future test periods.
2. The estimated projection component of both the stand-alone rate adjustment ratemaking and the formula rate does employ a future test period within the meaning of § 1.167(l)-1(h)(6)(ii) and therefore Taxpayer is required to use the proration methodology in order to comply with the normalization rules.
3. The true-up component of both the stand-alone rate adjustment ratemaking and the formula rate does not employ a future test period within the meaning of § 1.167(l)-1(h)(6)(ii) and therefore Taxpayer is not required to use the proration methodology in order to comply with the normalization rules.
4. In Taxpayer's stand-alone rate adjustment proceedings, an adjustment to eliminate from the Taxpayer's cash working capital allowance any provision for accelerated depreciation-related ADFIT if the proration methodology is employed does conflict with the normalization rules.
5. In order to comply with the consistency requirement of the normalization rules, it is not necessary that the Taxpayer use the same averaging convention it uses in computing the other elements of rate base in computing its ADFIT balance for purposes of the formula rates.

6. The Service rules adversely with respect to Rulings 1 and 2, above. Any failure by Taxpayer to employ the proration methodology prior to the proceedings in Cases A, B, or C or the effective date approved by Commission C for the requested modification of the formula rates was not a violation of the normalization rules requiring sanctions for such violation.
7. Because the Service rules favorably with respect to Ruling 5, above, Taxpayer's requested Ruling 7 is moot.

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
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

154 FERC ¶ 61,126
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Cheryl A. LaFleur, Tony Clark,
and Colette D. Honorable.

PJM Interconnection, L.L.C. Docket No. ER14-1831-001
Virginia Electric and Power Company

ORDER ON REVISED ADIT TREATMENT

(Issued February 23, 2016)

1. On October 30, 2015, Virginia Electric and Power Company, doing business as Dominion Virginia Power (Dominion), submitted a compliance filing in the above referenced proceeding, following its receipt of an Internal Revenue Service (IRS) Private Letter Ruling (PLR).[1] As discussed below, we accept these company-specific revisions to Attachment H-16 of PJM Interconnection, L.L.C.'s (PJM) Open Access Transmission Tariff (Tariff), with an effective date of May 1, 2014, as requested.[2]

I. Background

2. Under Commission ratemaking policies, income taxes included in rates are determined based on the return on net rate base calculated using straight-line depreciation. However, in calculating the actual amount of taxes due to the IRS, companies generally are able to take advantage of accelerated depreciation. Accelerated depreciation will generally lower taxes payable during the early years of an asset's life followed by corresponding increases in taxes payable during the later years of an asset's life. This means that a company's income taxes payable in a period will differ from its income tax expense in the same period for ratemaking purposes. The difference between the income taxes based on straight-line-depreciation and the actual taxes paid by the company are reflected in an account called Accumulated Deferred Income Taxes (ADIT)

[1] I.R.S. Priv. Ltr. Rul. 143241-14 (July 6, 2015) (PLR).

[2] PJM Interconnection, L.L.C., Intra-PJM Tariffs, OATT ATT H-16A, OATT Attachment H-16A - Virginia Electric, 6.0.0.

or Accumulated Deferred Federal Income Taxes (ADFIT). Because the customers are, in effect, pre-paying taxes and providing the company with cost-free capital, the Commission subtracts the ADFIT from the company's rate base thereby reducing customer charges. This method of passing the benefits from accelerated depreciation on to ratepayers throughout the asset's life is referred to as tax normalization.

3. The depreciation normalization rules of the Internal Revenue Code (Normalization Rules) mandate the use of a very specific proration procedure in measuring the amount of future test period ADFIT that can reduce rate base. The IRS requires, for a utility that solely utilizes a future period (projected test year) to determine depreciation, that "the amount of the reserve [for deferred taxes] for the period is the amount of the reserve at the beginning 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 such period."[3] The pro rata amount of any increase or decrease during the future portion of the period is determined by multiplying the increase or decrease by a fraction, the numerator of which is the number of days remaining in the period at the time the increase is to accrue, and the denominator of which is the total number of days in the future portion of the period.[4] The purpose of the Proration Requirement is to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers, allowing funds provided by accelerated depreciation to be used for investments.

4. The IRS requires utilities to follow its regulations in order to take advantage of accelerated depreciation. Dominion and other electric utilities have requested revenue rulings from the IRS regarding the calculation of ADFIT for formula rates which include a projection of expected investments for the coming year. These formula rates also include a true-up mechanism through which the utility calculates adjustments to its formula, for example, for the differences from investments that did not occur when projected.

5. On April 30, 2014, Dominion filed in Docket No. ER14-1831-000, pursuant to section 205 of the Federal Power Act,[5] to change the methodology it uses to calculate the ADFIT component of its rate base to bring it into compliance with the Normalization Rules and thereby continue the availability of accelerated tax depreciation to the benefit of its customers. Specifically, Dominion stated that the IRS's proration formula must be applied to its ADFIT balance (Proration Requirement). Additionally, Dominion asserted that once the proration formula is applied, the ADFIT balance used to reduce rate base

[3] Treas. Reg. § 1.167(1)-1(h)(6)(ii).

[4] *Id.*

[5] 16 U.S.C. § 824d (2012).

must be calculated using the same 13-month average that is used in calculating the net plant component of rate base (Consistency Requirement). In a June 2014 Order,[6] the Commission ruled that Dominion's particular tax question was "a case of first impression before this Commission … on the specific matters of tax law raised," and ruled "that it is necessary to obtain the IRS's interpretation of how its Normalization Rules apply in the context of Dominion's Formula Rates."[7] Accordingly, the June 2014 Order formally established a hearing, but held all proceedings at the Commission in abeyance until Dominion received guidance directly from the IRS. On July 6, 2015, the IRS released that guidance in the form of a PLR, which is its primary mode of ruling on fact-specific questions of interpreting the tax code.

6. On August 14, 2015, Dominion filed the PLR in this docket and announced that it had taken effect under IRS rules of procedure. Dominion had asked the IRS:

> to determine whether the Proration and Consistency Requirements of the Normalization Rules are required in the case of a rate recovery mechanism, whereby: (1) the cost of service test period includes projected periods, i.e., periods subsequent to the effective date of the rates, and (2) the differences between such projected costs and the utility's actual incurred costs are included as an adjustment to cost-of-service in the next resetting of the rates for the recovery mechanism.[8]

According to Dominion, the PLR announced seven conclusions, five of which conformed with Dominion's expectations as reflected in its original filing, and two of which differed from Dominion's expectations.[9] In particular, Dominion characterizes the IRS as ruling:

> while the Proration Requirement applies to all future test periods and the estimated projection components of the Formula Rate, the Proration Requirement is not applicable to the increase of actual ADIT activity above the original projections when computing the true-up portion of the Formula Rate. It also ruled that the Consistency Requirement

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[6] *PJM Interconnection, L.L.C.*, 147 FERC ¶ 61,254 (2014) (June 2014 Order).

[7] *Id.* P 18.

[8] Dominion August 14, 2015 Supplemental Filing at 2.

[9] *Id.* at 2.

> was not violated by using the two different averaging methodologies for plant components of rate base and related ADIT that has been historically used in Dominion's Formula Rate.

Dominion sought, and was granted, additional time to revise its tariff proposal to be in line with the IRS's determinations.

7. On October 30, 2015, Dominion submitted the instant compliance filing. Dominion addressed the calculation of ADFIT for use in both the projected test period and the true-up adjustment. Regarding the projected test period, Dominion states that its proposal on April 30, 2014, in which Dominion proposed to use proration in calculating ADFIT, is generally consistent with the PLR. However, Dominion asserts that it is unnecessary to use the same 13-month average that it uses to calculate net plant for ADFIT, and Dominion instead proposes to use an average based on the beginning-of-year and end-of -year prorated values. Dominion cites the PLR's finding that "[w]hile there are minor differences in the convention used to average all elements of rate base including depreciation expense on the one hand, and ADFIT on the other… it is sufficient that both are determined by averaging and both are determined over the same period of time."[10]

8. Regarding the true-up adjustment, Dominion proposes to retain the IRS's proration methodology for the originally projected ADFIT amount, but not to apply proration to any actual ADFIT activity in excess of that amount. In support of its proposed changes to the true-up calculation, Dominion refers to the PLR's finding that "In calculating the true-up, proration applies to the original projection amount but the actual amount added to the ADFIT over the test year is not modified by application of the proration formula."[11] Dominion contends that although this ruling "might at first appear counterintuitive, it preserves both the economic effect of the IRC-required proration and the definitions of 'future' and 'historical' test periods provided in the PLR."[12] Dominion advises that it has confirmed with the IRS that this was the intent of the PLR.[13]

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[10] PLR at 10, *cited in* Dominion October 30, 2015 filing at 6.

[11] PLR at 7, *cited in* Dominion October 30, 2015 filing at 7.

[12] Dominion October 30, 2015 filing at 7.

[13] *Id.*

II. Notice and Responsive Pleadings

9. Notice of Dominion's filing was published in the Federal Register, 80 Fed. Reg. 68,528 (2015), with interventions and protests due on or before November 20, 2015. Virginia Municipal Electric Association No. 1, Old Dominion Electric Cooperative, and the North Carolina Electric Membership Corporation intervened and jointly (collectively, Indicated Customers) filed a timely protest. On December 8, 2015, Dominion filed a motion for leave to answer and answer to the protest of Indicated Customers. On December 22, 2015, Indicated Customers filed an answer to Dominion's answer.

10. Indicated Customers allege that Dominion misinterprets certain aspects of the IRS's regulations and the PLR's guidance. First, Indicated Customers complain that after Dominion performs its proration calculation, it takes the extra step of averaging the beginning and ending balance.[14] Indicated Customers contend that this extra step is duplicative, because the proration process itself has the effect of averaging ADFIT balance over the December-to-December period. Second, Protestors contend that Dominion has incorrectly interpreted the IRS's response in the PLR to mean that only the difference between the forecast of the ADFIT during the year and the amount of ADFIT that was actually booked is exempt from the proration requirement.[15] Indicated Customers contend that it is "the actual amount added to the ADFIT over the test year" – that is, all of the ADFIT accrued during the test year – that is exempt from proration, not merely the difference between the projection and the actual amount.[16] Finally, Indicated Customers object to Dominion's proposed effective date. Indicated Customers assert that there is no need to restate the 2014 and 2015 projected amounts for ADFIT to reflect proration, since the projected rates have already been paid by transmission customers.

11. In answering the Indicated Customers' Protest, Dominion argues that the IRS's regulations require proration of the test period data and averaging of the prorated data over that period.[17] According to Dominion, under the Consistency Requirement, it must apply the same convention (e.g., an averaging convention) to the prorated ADFIT amounts that it applies to the other elements of rate base. However, Dominion notes that the Consistency Requirement accommodates the use of variations in averaging conventions. In other words, the averaging methodology used for ADIT and other components of rate base can be based upon different conventions provided all related

[14] Indicated Customers Protest at 4.

[15] *Id.* at 5.

[16] *Id.*

[17] Dominion Answer at 5-7.

components (plant, accumulated depreciation, ADIT) are averaged.[18] Thus, Dominion explains that, since it averages balances in calculating other elements of its rate base, it must apply an averaging convention to the prorated ADFIT balances as well.[19]

12. With respect to the true-up, Dominion argues that the PLR requires it to preserve the proration of the ADFIT that was used for projected rates. Dominion explains that the PLR describes the true-up component as a reconciliation mechanism wherein actual amounts that are in excess of projections are collected from customers in a subsequent rate year.[20] Dominion quotes the PLR as stating, "the true up increases the ultimate accuracy of the rates but does not convert a future test period into a historical test period as those terms are used in the normalization regulations."[21] Dominion suggests that, under IRS regulations, a true-up is not the same as a historical test period. Dominion further notes that the PLR holds, "[i]n calculating the true-up, proration applies to the original projection amount but the actual amount added to the ADFIT over the test year is not modified by application of the proration formula."[22] Dominion explains that the true-up amount to be billed to customers represents only the difference between a revenue requirement determined in that recalculation and the revenue requirement determined in the original projected component of the formula rate. Dominion advises that recognition of this distinction is critical to understanding the PLR guidance provided by the IRS.

13. According to Dominion, the true-up adjustment included within the Annual Transmission Revenue Requirement (ATRR), as reflected in Dominion's formula rate templates, is limited to the ADFIT included in the projected component of the formula rate but not to the incremental changes in ADFIT (the "actual amount added") attributable to the differences between the projected amounts already included in the rate period and the total actual ADFIT balances. Dominion explains that it is only such differences in ADFIT activity, rather than the entirety of the ADFIT activity reflected in the recalculation, that would occur before the effective date of attendant rates or be considered *historical* as that term is used by the IRS in its interpretation of the proration

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[18] *Id.*

[19] Dominion Answer at 7 (citing I.R.S. Priv. Ltr. Rul. 9202029 (October 15, 1991); I.R.S. Priv. Ltr. Rul. 9313008 (December 17, 1992); I.R.S. Priv. Ltr. Rul. 9224040 (March 16, 1992)).

[20] Dominion Answer at 9.

[21] PLR at 8, *cited in* Dominion Answer at 12.

[22] PLR at 8, *cited in* Dominion Answer at 8.

formula provisions of its regulations. On the other hand, projected ADFIT activity, to the extent realized, has already impacted the revenue requirement underlying customer rates that became effective prior to the projected periods. Accordingly, only the differences are not subject to the proration requirements, Dominion argues.

14. Regarding its requested effective date, Dominion states that its goal is to limit the period of non-compliance with the Normalization Rules. Dominion states that its proposal would apply the PLR-compliant true-up computation beginning with the May 1, 2014 effective date established by the Commission (subject to refund) in this proceeding. Dominion states that this does not involve applying the Normalization Rules to the projections for 2014 through 2016.

15. Dominion states that if the Commission's decision in this proceeding varies from Dominion's understanding of the PLR, Dominion may determine that a subsequent PLR request is required to provide confirmation that the resulting tariff conforms to the IRS's requirements.

16. In their December 22, 2015 answer, Indicated Customers reiterate the objections summarized above. Indicated Customers assert that Dominion's proposal will needlessly increase rates for customers.

III. Discussion

17. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,[23] the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure prohibits an answer to a protest unless otherwise ordered by the decisional authority.[24] We will accept Dominion's December 8, 2015 answer and Indicated Customers' December 22, 2015 answer.

18. In this filing, Dominion seeks to have the Commission accept revisions to its formula rate to reflect the IRS's regulations for calculating deferred income taxes for purposes of determining Dominions Transmission Formula Rate. Dominion asserts that these revisions are necessary in order to preserve Dominion's ability to use accelerated depreciation for federal income tax purposes. We agree with Dominion that its proposal is a reasonable interpretation of the PLR.

[23] 18 C.F.R. § 385.214 (2015).

[24] 18 C.F.R. § 385.213(a)(2) (2015).

19. In recent orders, the Commission has clarified that, when a section 205 filing is strictly limited to tax matters, the Commission will base its evaluation on whether "the proposed revisions are reasonable to comply with IRS regulations,"[25] and expressly rejected the "objection that Private Letter Rulings issued by the IRS cannot be a basis for [] proposed rate revisions."[26] The Indicated Customers, following this guidance, have limited its protest to arguing "that Dominion has misinterpreted certain aspects of the IRS's guidance."[27] Accordingly, Indicated Customers argue that, "Dominion has improperly calculated the net prorated amount for use in the projected formula rates,"[28] and "also misunderstood the guidance provided by the PLR regarding the true-up component of the formula rate;"[29] the Indicated Customers' requested revisions to Dominion's rates all flow from this argument.

20. Indicated Customers maintain that Dominion has added an unrequired separate step of averaging the beginning and ending ADFIT balances not required by the PLR. They maintain that prorationing is an average and that Dominion therefore should use the end of year pro rated ADFIT balance, as opposed to the simple average. We find, however, that Dominion's methodology is reasonable. Dominion's proposal determines the average rate base by taking the average net plant and subtracting an average of ADFIT values.[30] As the PLR states: "[w]hile there are minor differences in the convention used to average all elements of rate base including depreciation expense on the one hand, and ADFIT on the other… it is sufficient that both are determined by averaging and both are determined over the same period of time."[31] This interpretation

[25] *Midcontinent Independent System Operator, Inc.*, 153 FERC ¶ 61,371, at P 36 (2015).

[26] *Id.* P 40.

[27] Indicated Customers' Protest at 3.

[28] *Id.* at 4.

[29] *Id.*

[30] Prorating an investment over time is not the equivalent of an average. Prorating weights the ADFIT from projected investments by the month in which they are incurred; an average uses the prorated monthly ADFIT values and determines the central or typical value from those data.

[31] PLR at 10, *cited in* Dominion October 30, 2015 filing at 6.

also is consistent with the interpretation of other utilities applying the IRS regulations regarding proration.[32]

21. Indicated Customers also object to Dominion's proposal to retain the IRS's proration methodology for the originally projected ADFIT amount. This treatment is consistent with the PLR, which states "in calculating the true-up, proration applies to the original projection amount but the actual amount added to the ADFIT over the test year is not modified by application of the proration formula."[33] Indicated Customers' contention that unweighted values should be used for the true-up would effectively undo the proration calculation of rates required by the IRS.

22. Finally, Indicated Customers object to Dominion's proposed May 1, 2014 effective date. However, the PLR states that "[a]ny rates that have been calculated using procedures inconsistent with this ruling ('nonconforming rates') which are or which have been in effect and which, under the applicable state or federal regulatory law, can be adjusted or corrected to conform to the requirements of this ruling, must be so adjusted or corrected."[34] Dominion's filing is consistent with the PLR.

The Commission orders:

Dominion's filing is accepted, effective May 1, 2014, as requested.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

[32] *See, e.g., Midcontinent Independent Transmission Operator, Inc.*, 153 FERC ¶ 61,374 (2015).

[33] PLR at 7, *cited in* Dominion October 30, 2015 filing at 7.

[34] PLR at 10, *cited in* Dominion December 8, 2015 Answer at 15.

Document Content(s)

156 FERC ¶ 61,200
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Cheryl A. LaFleur, Tony Clark,
and Colette D. Honorable.

PJM Interconnection, L.L.C. Docket No. ER14-1831-003
Virginia Electric and Power Company

ORDER DENYING REHEARING

(Issued September 22, 2016)

1. On March 24, 2016, Old Dominion Electric Cooperative, the North Carolina Electric Membership Corporation, and Virginia Municipal Electric Association No. 1 (Indicated Customers) filed for rehearing of the Commission's February 23, 2016 order[1] accepting Virginia Electric and Power Company's (VEPCO) revision to its formula rate to change its methodology for calculating Accumulated Deferred Income Tax (ADIT) to accord with IRS methodology and an Internal Revenue Service (IRS) Private Letter Ruling (PLR).[2]

2. For the reasons discussed below, we deny rehearing.

I. Background

3. The February 23, 2016 order provides a detailed background of the proceeding. As relevant to the rehearing, the Commission adjusts for the use of accelerated methods of depreciating utility property in calculating rates through its use of tax normalization.[3] Under Commission ratemaking policies, income taxes included in rates are determined based on the return on net rate base calculated using straight-line depreciation. However,

[1] *PJM Interconnection, L.L.C. & Virginia Electric & Power Co.*, 154 FERC ¶ 61,126 (2016) (February 23, 2016 order).

[2] I.R.S. Priv. Ltr. Rul. 143241-14 (July 6, 2015) (2015 PLR).

[3] 18 C.F.R § 35.24 (2016).

in calculating the actual amount of income taxes due and payable to the IRS, companies generally are able to take advantage of accelerated depreciation methods. Accelerated depreciation will generally lower federal income taxes payable during the early years of an asset's life followed by corresponding increases in taxes payable during the later years of an asset's life.[4] This means that a company's income taxes due and payable in a period will differ from its income tax expense in the same period for ratemaking purposes. The difference between the income taxes based on straight-line-depreciation and the actual taxes paid by the company are reflected in an account called ADIT or Accumulated Deferred Federal Income Taxes (ADFIT).[5] A positive ADIT account reflects, in effect, taxes the customers pre-pay during the early years of an asset's life providing the company with funds to pay taxes after the accelerated depreciation period ends.[6] Because the customers are, in effect, providing the company with cost-free capital during the period of accelerated depreciation, the Commission subtracts the ADIT balance from the company's rate base thereby lowering customer rates.[7]

4. The IRS requires that utilities seeking to claim accelerated depreciation on their federal income tax returns must compute their tax expense for ratemaking purposes using a tax normalization method of accounting. As part of the normalization, the IRS requires that utilities use a proration methodology whenever rates include future projections of rate base. The IRS explains that the "purpose of the proration formula is to prevent the

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[4] This occurs because the deductions computed using accelerated depreciation for tax purposes differ from the depreciation expense computed using straight-line depreciation on the company's books for ratemaking purposes.

[5] Accumulated deferred income taxes are amounts that reflect the tax reduction (or increase) resulting from the differences between the periods in which transactions affect taxable income and the periods in which they enter into the determination of accounting (book) income. *See* 18 C.F.R. Part 101, General Instruction 18 (2016).

[6] After accelerated depreciation of an asset ends, the Commission's use of straight-line depreciation would not provide sufficient revenue to cover the extra taxes owed. The ADIT account records the pre-paid taxes that provide the amount needed to pay the higher taxes when accelerated depreciation has ended.

[7] The ADIT balance may become negative when the depreciation expense based on straight-line depreciation expense included in rates exceeds the depreciation expenses, based on accelerated depreciation, allowed for tax purposes. Amounts recorded as ADIT, therefore, reverse in later years and rate base will increase, with a consequent increase in rate base and higher customer rates.

immediate flow-through of the benefits of accelerated depreciation to ratepayers."[8] Utilities that do not employ the proration formula may not be permitted to take advantage of accelerated depreciation.

5. The IRS requires that when a utility's test period for determining rates is part historical and part projected, the amount of the ADIT reserve is the ADIT at the end of the historical portion of the period and a pro rata amount of any projected increase to be credited to the account during the future portion of the period.[9] In effect, the IRS requires that increases and decreases in the future projection of rate base be determined based on the number of days remaining in the period at the time of the increase or decrease. The purpose of the proration requirement is to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers based on the actual time these amounts are expected to be in the ADIT account, thereby allowing funds provided by accelerated depreciation to be used for investments.

6. VEPCO uses a formula rate to determine the rates it will charge for an upcoming year and relies on projected investments for the upcoming year in calculating that rate. VEPCO's formula rate includes a true-up mechanism through which it calculates adjustments to its formula, for example, for the differences from investments that did not occur when projected or for investments which occurred at a different period than projected.

7. Because VEPCO was concerned its prior formula rate did not comply with the IRS's proration requirement, it filed in this docket to revise its formula rate to reflect the IRS's policy and also filed in the various states in which it operates. The Commission established a hearing, but held the hearing in abeyance while VEPCO received guidance from the IRS through a private revenue ruling regarding its proposed method of prorating its projected investment.[10] Based on the VEPCO filing and the 2015 PLR, VEPCO revised its prior methodology for using the proration methodology for ADIT, which the Commission accepted.

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[8] 2015 PLR at 6. As the IRS explains, proration ensures that the subtraction of ADIT from rate base for projected investments takes "into account the factor of time for which such amounts are held by the taxpayer." *Id.*

[9] Treas. Reg. § 1.167(l)-1(h)(6)(ii).

[10] One of the states in which VEPCO operates required that it obtain such guidance. 2015 PLR at 3.

8. Indicated Customers object to the use of the proration methodology to determine the rate to be charged by VEPCO for the projected year. Indicated Customers seek rehearing only as to VEPCO's methodology for determining the true-up.

9. VEPCO's initial proposal applied the proration requirement both to the projected rates and to the true-up mechanism. Based on the 2015 PLR, VEPCO revised its approach for the true-up to retain the IRS's proration methodology for the originally projected ADIT amount, but not for differences in ADIT resulting from the true-up. In support of its proposed changes to the true-up calculation, VEPCO refers to the 2015 PLR's finding that "in calculating the true-up, proration applies to the original projection amount but the actual amount added to the ADFIT over the test year is not modified by application of the proration formula."[11] VEPCO contended that its approach to proration "preserves both the economic effect of the [Internal Revenue Code]-required proration and the definitions of 'future' and 'historical' test periods provided in the PLR."[12] VEPCO stated that it confirmed those conclusions with IRS.[13] In the February 23, 2016 order, the Commission accepted VEPCO's approach to the true-up mechanism finding its "treatment is consistent with the PLR," which states "in calculating the true-up, proration

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[11] 2015 PLR at 7 (cited in VEPCO October 30, 2015 Filing at 7).

[12] VEPCO October 30, 2015 Filing at 7. VEPCO's witness, James I. Warren, provided an example of the logic of VEPCO's proposal.

> The situation that most clearly illustrates the logic of this holding would be where the Company sets projection-based formula rates in one period and, when it proceeds to calculate true-up-based formula rates, determines that each and every projection, including deferred tax balances, was 100% accurate. Under the IRS holding, there would be no true-up. The proration used in the calculation of projection-based rates would be preserved. The alternative would be to calculate a true-up based exclusively on reversing the effect of the proration that had been used to calculate the projection-based rates. This alternative conclusion would, as a practical matter, emasculate the proration requirement.

Ex. DVP 6 at 10.

[13] Ex. DVP at 10.

applies to the original projection amount but the actual amount added to the ADFIT over the test year is not modified by application of the proration formula."[14]

II. Rehearing Request

10. Indicated Customers contend the Commission erred in accepting VEPCO's true-up proposal as it is "in direct contradiction with the PLR."[15] They argue that the true-up is calculated after the future period has ended and is therefore based on purely historical information. They cite to statements in the 2015 PLR which they believe indicate that proration should not be used for historical values.

III. Procedural Matters

11. VEPCO filed a motion requesting leave to file an answer to Indicated Customers rehearing request. Rule 713(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d)(1)(2016), prohibits an answer to a request for rehearing. Accordingly, we deny VEPCO's motion to answer and reject VEPCO's answer to the rehearing request.

IV. Discussion

12. We deny rehearing. The Commission's policy is to encourage utilities to use accelerated depreciation, because it provides the utility with cost free capital during the early years of the investment, which redounds to the benefit of utility customers. Taking accelerated depreciation benefits customers by lowering the utility's taxes, thereby providing the utility with cost-free capital for investment.[16] Here, VEPCO seeks to retain accelerated depreciation and made this filing to ensure that it satisfies the IRS requirements.

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[14] February 23, 2016 order, 154 FERC ¶ 61,126, at P 21; 2015 PLR at 7 (cited in VEPCO October 30, 2015 Filing at 7).

[15] Rehearing Request at 5.

[16] *Midcontinent Indep. Sys. Operator, Inc. & ITC Midwest LLC*, 154 FERC ¶ 61,187 (finding imprudent a utility's decision not to avail itself of bonus depreciation), *reh'g denied*, 155 FERC ¶ 61,248 (2016). *See also, Midwestern Gas Transmission Co. v. FPC*, 388 F.2d 444 (7th Cir. 1968) (affirming a Commission determination to determine rates using a depreciation approach that maximizes tax savings), *cert. denied*, 392 U.S. 928 (1968).

13. Indicated Customers contend VEPCO's true-up proposal (to retain the IRS's proration methodology for the originally projected ADIT amount during the true-up and apply actual ADIT values for any changes in ADIT resulting from the true-up) is "in direct contradiction" to the 2015 PLR.[17] We find that, based on the 2015 PLR, VEPCO's filing is based on a reasonable interpretation of the positons taken by the IRS and is just and reasonable. Both VEPCO and Indicated Customers rely on many of the same statements in the 2015 PLR. In particular, they both cite to this statement in the 2015 PLR:

> In contrast to the projections discussed above, the true-up component is determined by reference to a purely historical period and there is no need to use the proration formula to calculate the differences between Taxpayer's projected ADFIT balance and the actual ADFIT balance during the period. In calculating the true-up, proration applies to the original projection amount but the actual amount added to the ADFIT over the test year is not modified by application of the proration formula.[18]

14. The purpose of having a true-up as part of formula rates is to reconcile the amounts projected with the actual amounts incurred, so that ratepayers pay accurate rates.[19] In its filing, VEPCO maintains that its true-up formula complies with the 2015 PLR as it uses actual ADIT values for the reconciled amounts (the differences between the projected amounts and the actuals).

15. The 2015 PLR states "there is no need to use the proration formula to calculate the differences between Taxpayer's projected ADFIT balance and the actual ADFIT balance

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[17] Rehearing Request at 5. Other than the 2015 PLR, Indicated Customers cite no other IRS material to support their position.

[18] 2015 PLR at 8.

[19] The 2015 PLR describes the true-up similarly as recording a "reconciliation" of the differences between the projected values and the actual values. The 2015 PLR states that "*any differences* between anticipated amounts and actual amounts are reconciled by a 'true-up' mechanism at the end of the test year" under which "the *reconciliation amount* is either charged to ratepayers (if actual revenues are below estimates) or credited to ratepayers (if actual revenues exceed estimates) as part of the rates established for the forthcoming rate year" (emphasis added). 2015 PLR at 2.

during the period."[20] VEPCO's proposal appears to comply with this requirement as it does not use the proration formula for the reconciled differences. In its filing, VEPCO also points to the statement in the 2015 PLR that "in calculating the true-up, proration applies to the original projection amount but the actual amount added to the ADFIT over the test year is not modified by application of the proration formula."[21] This statement also supports VEPCO's approach of not modifying the prorated ADIT for the projection and using un-prorated values for the differences in ADIT resulting from changes in the projections. VEPCO further relies on the statement in the 2015 PLR that "the addition of the true up increases the ultimate accuracy of the rates but does not convert a future test period into a historical test period as those terms are used in the normalization regulations."[22] As VEPCO maintains, this statement reasonably may be interpreted as requiring the retention of proration for the projected amounts while the differences from the projected amounts are used for the true-up reconciliation.

16. Indicated Customers argue that VEPCO's approach is inconsistent with the conclusion of the 2015 PLR, which states: "the true-up component of both the stand-alone rate adjustment ratemaking and the formula rate does not employ a future test period within the meaning of § 1.167(l)-1(h)(6)(ii) and therefore Taxpayer is not required to use the proration methodology in order to comply with the normalization rules."[23] But this statement can be read consistently with VEPCO's interpretation of the other statements in the 2015 PLR, as under VEPCO's proposal, the "true-up component" reflects the differences between the projected and actual ADIT, and VEPCO does not prorate that difference.

17. Indicated Customers also maintain that the Commission erred in stating that their position is to use "unweighted values" in calculating the true-up. They assert their position is that the required proration had already been made when the VEPCO projected rates are calculated and, therefore, should not be duplicated in the true-up calculation. VEPCO's proposal, however, does not duplicate the proration of the ADIT in the true-up;

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[20] 2015 PLR at 8.

[21] *Id.*

[22] 2015 PLR at 7.

[23] 2015 PLR at 11.

rather, it applies the true-up only to the adjustment in ADIT that results from incorrect projections.[24]

18. We recognize that other utilities may have come to different interpretations of the IRS requirements and the meaning of the 2015 PLR as it applies to the true-up.[25] The IRS, not the Commission, however, should be the party interpreting the Internal Revenue Code. VEPCO requested a letter ruling from the IRS, and based its filing on the PLR and meetings with the IRS. In reviewing VEPCO's filing, Indicated Customers have not shown that VEPCO's interpretation of the 2015 PLR is in direct contradiction or inconsistent with the 2015 PLR, or that VEPCO's interpretation of the 2015 PLR will result in the IRS denying its use of accelerated depreciation based on the formula it has proposed.[26] In these circumstances, we cannot find that VEPCO has failed to support its proposed treatment of the true-up or that its proposed true-up mechanism is unjust and unreasonable. Should either party seek further IRS guidance, or if the IRS provides such guidance in another case, the Commission can revisit this issue upon a proper filing.[27]

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[24] In its filing, VEPCO maintains that if end of year values were used in the true-up, it would negate the use of proration for the projected year by restating the rates as if proration had not been used. It maintains that could not logically have been the intent of the IRS in requiring the use of proration. VEPCO Transmittal Letter, Docket No. ER14-1831-001, at 7 (10/30/2015), Ex. DVP 6 at 1, VEPCO Answer, Docket No. ER14-1831-000, at 9 (12/8/2015).

[25] *Compare Pub. Serv. Co. of Colorado,* 155 FERC ¶ 61,028 (2016) (interpreting the 2015 PLR as does VEPCO) *with Midcontinent Indep. Sys. Operator, Inc.*, 153 FERC ¶ 61,371 (2015) (did not retain proration in the true-up), *on reh'g,* Request for Clarification or, in the Alternative, Rehearing, Docket No. ER16-197-002 (1/29/2016) (Clarification request that parties may make a future filing if the IRS rules that proration methodology must continue to be applied to the originally projected ADIT in performing the annual true-up calculations) *and* Docket Nos. ER16-2378-000 at Transmittal Letter, at 4-5 (8/5/2016) and ER16-2386-000, Transmittal Letter, at 4-5 (8/5/2016) (tariff revisions to use proration, but continuing to use actual data in the true-up).

[26] The IRS may find that both approaches are reasonable means of implementing its regulations. Indicated Customers in its rehearing contends only that VEPCO's approach is in direct contradiction to the 2015 PLR.

[27] Parties seeking further IRS clarification could ask specifically whether a company would comply with the proration requirements if the company used proration in Year 1 in calculating its ADIT for prospective investments (and rates) for Year 2, and then used the actual beginning and end of year balances of ADIT (or a 13 month average

(continued ...)

However, based on the record here, we continue to find VEPCO's proposal just and reasonable and deny rehearing.

The Commission orders:

Rehearing is denied as discussed in the body of the order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

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of ADIT values) as part of the true-up in Year 3, with the effect of restating Year 2 rates as if proration has not been used.

Document Content(s)

155 FERC ¶ 61,028
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Cheryl A. LaFleur, and Colette D. Honorable.

Public Service Company of Colorado

Docket Nos. ER16-236-000
ER16-236-001
ER16-239-000
ER16-239-001

ORDER ACCEPTING REVISIONS TO FORMULA RATES, SUBJECT TO CONDITION

(Issued April 12, 2016)

1. On November 2, 2015, pursuant to section 205 of the Federal Power Act (FPA),[1] Public Service Company of Colorado (PSCo), on behalf of itself and its affiliate Southwestern Public Service Company (SPS), submitted proposed revisions to the transmission formula rates for PSCo and SPS included in the Xcel Energy Operating Companies' FERC Electric Tariff (Xcel Energy Tariff). Also on November 2, 2015, PSCo submitted proposed revisions to its production formula rate included in its Assured Power and Energy Requirements Service Tariff (Production Tariff). PSCo proposes these revisions in order to comply with section 1.167(l)-1(h)(6)(ii) of the United States Internal Revenue Service (IRS) regulations.[2] In this order, we accept the proposed revisions, effective January 1, 2016, as requested, subject to condition, and direct a compliance filing.

[1] 16 U.S.C. § 824d (2012).

[2] Treas. Reg. § 1.167(l)-1(h)(6)(ii) (as amended in 1974).

I. Background

2. Under Commission ratemaking policies, income taxes included in rates are determined based on the return on net rate base calculated using straight-line depreciation.[3] However, in calculating the actual amount of income taxes due to the IRS, companies generally are able to take advantage of accelerated depreciation. Accelerated depreciation will usually lower income taxes payable during the early years of an asset's life followed by corresponding increases in income taxes payable during the later years of an asset's life. This means that a company's income taxes payable to the IRS during a period will differ from its income tax expenses for ratemaking purposes during the same period. The difference between the income taxes based on straight-line-depreciation and the actual income taxes paid by the company are reflected in an account called Accumulated Deferred Income Taxes (ADIT).[4] Because the resulting ADIT effectively provides the company with cost-free capital, the Commission subtracts the ADIT from the company's rate base, thereby reducing customer charges. This method of passing the benefits from accelerated depreciation on to ratepayers throughout the asset's life is referred to as tax normalization.

3. The depreciation normalization rules of the Internal Revenue Code (Normalization Rules) mandate the use of a very specific proration procedure in measuring the amount of future test period ADIT that can reduce rate base. Section 1.167(l)-1(h)(6)(ii) of the IRS regulations requires that, if a utility uses solely a future period (projected test year) to determine depreciation, "the amount of the reserve account for the period is the amount of the reserve at the beginning 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 such period." The pro rata amount of any increase during the future portion of the period is determined by multiplying the increase by a fraction, the numerator of which is the number of days remaining in the period at the time the increase is to accrue, and the denominator of which is the total number of days in the future portion of the period.[5] The purpose of the

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[3] *See, e.g.*, *PJM Interconnection, L.L.C. and Va. Elec. and Power Co.*, 147 FERC ¶ 61,254, *order on compliance*, 154 FERC ¶ 61,126, at P 2 (2016) (*Virginia Electric*).

[4] There are four categories of ADIT recognized in the Uniform System of Accounts in four separate accounts; however, only three of these categories of ADIT are related to accelerated depreciation, including bonus depreciation: Accounts 190, Accumulated Deferred Income Taxes; 281, Accumulated Deferred Income Taxes-Accelerated Amortization Property; and 282, Accumulated Deferred Income Taxes-Other Property.

[5] Treas. Reg. § 1.167(l)-1(h)(6)(ii) (as amended in 1974).

proration requirement is to prevent the immediate flow-through of the benefits of accelerated depreciation to ratepayers, allowing funds provided by accelerated depreciation to be used for investments.

4. The IRS requires utilities to follow its regulations in order to take advantage of accelerated depreciation. Certain electric utilities have requested revenue rulings from the IRS regarding the calculation of ADIT for formula rates, which include a projection of expected investments for the coming year. These formula rates also include a true-up mechanism through which the utility calculates adjustments to its formula, for example, for the differences from investments that did not occur when projected.

II. PSCo's Filings

5. In Docket No. ER16-236-000, PSCo states that it is filing revisions to the Xcel Energy Tariff to modify the manner by which PSCo and SPS will calculate average ADIT balances within their transmission formula rates in order to comply with section 1.167(l)-1(h)(6)(ii) of the IRS regulations.[6] PSCo also filed proposed revisions to its Production Tariff in Docket No. ER16-239-000 to effectuate similar changes to the ADIT provisions within its production formula rate.[7] PSCo notes that SPS is not proposing to modify its production formula rates at this time.[8]

6. PSCo states that, in a series of private letter rulings (PLR), the IRS has found that, for a utility that uses a projected test year to claim accelerated depreciation for utility plant in its income tax filings, the utility must use the formula provided in section 1.167(1)-1(h)(6)(ii) of the IRS regulations to calculate the amount of deferred income taxes subject to exclusion from the rate base.[9] PSCo notes that the IRS has indicated that utilities subject to this requirement that do not seek to comply are subject to

[6] PSCo, Docket No. ER16-236-000, Transmittal at 1.

[7] PSCo, Docket No. ER16-239-000, Transmittal at 1.

[8] PSCo, Docket No. ER16-236-000, Transmittal at 4 n.13.

[9] *Id.* at 3; PSCo, Docket No. ER16-239-000, Transmittal at 3 (citing Exh. III, I.R.S. Priv. Ltr. Rul. 143241-14 (Jul. 6, 2015); I.R.S. Priv. Ltr. Rul. 140120-14 (Apr. 14, 2015)).

the sanction of denial of accelerated depreciation,[10] which would cause a significant increase in rate base and rates.[11]

7. PSCo states that PSCo and SPS calculate their annual transmission revenue requirements pursuant to the formulae set forth in Attachment O-PSCo and Attachment O-SPS of the Xcel Energy Tariff, respectively.[12] According to PSCo, both companies employ a forward-looking Attachment O, and each submits an annual informational filing with the Commission that consists of the true-up for the prior period actuals and the estimated rates for the upcoming rate year. PSCo states that it proposes to revise the Attachment O of each company to provide that the calculation of ADIT for both the annual projection and true-up will be performed in accordance with section 1.167(l)-1(h)(6) of the IRS regulations. Therefore, PSCo states that it proposes to include a new work paper (WP ADIT Prorate) in each Attachment O in the Xcel Energy Tariff, which calculates the proration factor according to the IRS regulations, and additional revisions and additions to existing work papers that describe how PSCo and SPS will calculate ADIT balances for both the projected test year revenue requirement and the annual true-up using the proration methodology required by the IRS.[13] PSCo further notes that the revisions included in the work papers maintain PSCo's and SPS's use of beginning of year and end of year ADIT balances, which is consistent with Commission requirements.[14]

8. PSCo states that it calculates its production rates pursuant to the forward-looking formulae set forth in Attachment A of its Production Tariff, and that it uses projected or estimated data to set its production rates, in conjunction with a process that trues up the rate based on actual data.[15] Therefore, similar to the proposed revisions in PSCo's and SPS's transmission formula rates, PSCo proposes to revise ADIT-related work papers in

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[10] PSCo, Docket No. ER16-236-000, Transmittal at 3-4; PSCo, Docket No. ER16-239-000, Transmittal at 3.

[11] PSCo, Docket No. ER16-236-000, Transmittal at 6; PSCo, Docket No. ER16-239-000, Transmittal at 5.

[12] PSCo, Docket No. ER16-236-000, Transmittal at 2.

[13] *Id*. at 4.

[14] *Id*. at 4-5 (citing 18 C.F.R. § 35.13(h)(6) (2015)).

[15] PSCo, Docket No. ER16-239-000, Transmittal at 2.

Attachment A by adding a new work paper (WP ADIT Prorate) to provide that the calculation of ADIT for both the annual projected revenue requirement and the true-up for its production formula rate will be performed in accordance with section 1.167(l)-1(h)(6) of the IRS regulations.[16] PSCo also notes that its revisions maintain the use of beginning of year and end of year ADIT balances.[17]

9. According to PSCo, using the proration formula increases PSCo's estimated 2016 annual transmission revenue requirement by $579,000, which represents a 0.2 percent increase over its $244 million revenue requirement. Similarly, PSCo states that the use of the proration formula increases SPS's estimated 2016 annual transmission revenue requirement by $416,000, which represents a 0.3 percent increase over its $129 million revenue requirement. With regard to PSCo's production formula rate, PSCo notes that use of the proration formula increases PSCo's estimated 2016 production revenue requirement by $102,000, which is a 0.1 percent increase above the total production revenue requirement of $81.7 million. PSCo states that, due to the timing of when it became aware of the need to revise the formula rates, PSCo's and SPS's 2016 estimates did not reflect the new ADIT proration formula. However, PSCo notes that it and SPS have notified customers of the need to modify the formula rates and that, before the end of 2015, it and SPS will provide customers with updated transmission and production formulas and associated work papers that reflect the incorporation of the proration formula.[18]

10. In addition to the ADIT-related revisions requested in Docket No. ER16-236-000, PSCo also proposes tariff revisions in SPS's Attachment O Tables 6 and 11 to reflect revisions agreed to as part of a recent settlement agreement in Docket No. EL05-19-000.[19] PSCo notes that SPS will be submitting compliance filings to implement the revisions agreed upon in the settlement proceeding, to be effective on January 1, 2015, but that, in order to avoid a circumstance where the eTariff records related to the instant proceeding (effective January 1, 2016) do not include the settlement agreement revisions to Table 6

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[16] *Id*. at 4.

[17] *Id*. (citing 18 C.F.R. § 35.13(h)(6) (2015)).

[18] PSCo, Docket No. ER16-236-000, Transmittal at 6-7; PSCo, Docket No. ER16-239-000, Transmittal at 5-6.

[19] *See Golden Spread Elec. Coop. Inc. v. Sw. Pub. Serv. Co.*, 153 FERC ¶ 61,103 (2015) (*Golden Spread*).

and 11, SPS is including such revisions as part of the tariff changes proposed in the instant proceeding.[20]

III. Notice and Responsive Pleadings

11. Notice of PSCo's filing in Docket No. ER16-236-000 was published in the *Federal Register*, 80 Fed. Reg. 69,212 (2015), with interventions and protests due on or before November 23, 2015. On November 23, 2015, Golden Spread Electric Cooperative (Golden Spread) filed a timely motion to intervene and an unopposed request for limited extension of comment date, which the Commission granted. On November 30, 2015, Golden Spread filed a limited protest and request for hearing and settlement judge procedures. On December 11, 2015, Tri-State Generation and Transmission Association (Tri-State), Intermountain Rural Electric Association (IREA), and Holy Cross Electric Association (Holy Cross) filed a joint motion to intervene out-of-time. On December 15, 2015, Xcel Energy Services Inc. (Xcel Energy) filed an answer to Golden Spread's protest.

12. Notice of PSCo's filing in Docket No. ER16-239-000 was published in the *Federal Register*, 80 Fed. Reg. 69,212 (2015), with interventions and protests due on or before November 23, 2015. On December 11, 2015, Tri-State, IREA, and Holy Cross filed a joint motion to intervene out-of-time.

13. On December 23, 2015, Commission staff advised PSCo that its filings were deficient and additional information would be necessary to evaluate its submissions.[21] On January 21, 2016, Xcel Energy, on behalf of PSCo, requested an extension of time for the filing of its response, which the Commission granted. On February 12, 2016, PSCo filed its response.

14. Notice of PSCo's Deficiency Response was published in the *Federal Register*, 81 Fed. Reg. 8954 (2016), with interventions and comments due on or before March 4, 2016. On March 4, 2016, Golden Spread filed a protest to the Deficiency Response and renewed request for hearing and settlement judge procedures. On March 21, 2016, Xcel Energy filed an answer to Golden Spread's protest.

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[20] PSCo, Docket No. ER16-236-000, Transmittal at 5-6.

[21] *Pub. Serv. Co. of Colo.*, Deficiency Letter, Docket No. ER16-236-000, *et al.*, at 1 (issued Dec. 23, 2015) (Deficiency Letter).

A. Golden Spread Protest

15. Golden Spread notes that it is not a transmission customer of PSCo, and therefore, protests the proposed changes in Docket No. ER16-236 solely as they relate to the transmission rates of SPS.[22] Golden Spread asserts that it has identified four errors with PSCo's proposal for SPS.[23] First, Golden Spread claims that, after SPS performs its proration calculation, it takes the extra step of averaging the beginning and ending balance, which has the undesired consequence of cutting the calculated proration in half, from 53.78 percent to 26.89 percent. Second, and related to the first error, Golden Spread argues that, when SPS carries the calculated proration amount in column (f) to the next column of Worksheet D, it performs an extra calculation that once again skews the appropriate IRS-compliant prorated balance that SPS should use as an average rate base balance in projected formula rates.[24] Using Account 281 from Worksheet D of the 2016 SPS Projection as an example, Golden Spread states that the effect of these first two errors results in a calculated projected average balance with an ADIT proration of -$1,635,436.[25] Golden Spread contends that the correct projected average balance with an ADIT proration that complies with the IRS regulations should be -$1,723,515.[26]

16. Third, Golden Spread states that it appears that SPS intends to create an ADIT proration for the true-up component of the formula rate as well.[27] According to Golden Spread, while PSCo and SPS have not sought their own PLRs from the IRS, guidance found in a PLR attached as Exhibit III to the PSCo and SPS filing directly contradicts the proposed tariff changes, and, therefore, columns (k), (l), (m), and (n) of Worksheet D of SPS's transmission formula rate should be removed and replaced with a

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[22] Golden Spread Limited Protest at 2 & n.4.

[23] *Id*. at 4 (citing Attachment 1 (Worksheet D)).

[24] *Id*. (citing Attachment 1 (Worksheet D, column (g))).

[25] *Id*. at 5.

[26] *Id*.

[27] *Id*. at 6 (citing Attachment 1 (Worksheet D, columns (k), (l), (m), (n))).

column representing the existing practice of calculating an average beginning of year and end of year balance for the purposes of the true-up calculation.[28]

17. Finally, Golden Spread notes that SPS's proposed tariff changes lack sufficient detail to differentiate between those account balances to which it must apply a proration to comply with IRS regulations and those for which it should continue to use a simple average of beginning and year end projected balances in Worksheet D average rate base calculations of the SPS formula.[29] Golden Spread argues that SPS should be directed to clarify on Worksheet D of its transmission formula rate that only items that are subject to IRS regulations addressing accelerated depreciation should be subject to any application of a proration in the projected rate columns.

18. Golden Spread believes that a nominal suspension is appropriate, such that SPS's rates may become effective subject to refund on January 1, 2016.[30] To the extent that the Commission does not summarily require correction of the formula rate in its order, Golden Spread requests that the Commission set the issues associated with SPS's proration process for hearing and hold the hearing in abeyance, pending the outcome of the *Virginia Electric*[31] proceeding and/or the issuance of industry-wide guidance by the Chief Accountant on this topic.[32]

B. Xcel Energy Answer

19. Xcel Energy contends that the use of the proration formula in conjunction with beginning of year and end of year averaging is necessary to meet the IRS's normalization requirements.[33] Xcel Energy asserts that a purpose of the calculations in Worksheet D and

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[28] *Id*. at 7 (citing PSCo and SPS Filing, Docket No. ER16-236-000, *et al*., Exh. III (I.R.S. Priv. Ltr. Rul. 143241-14 at 12) and noting that the private letter ruling offered by PSCo and SPS is not binding precedent).

[29] *Id*. at 7-8.

[30] *Id*. at 10.

[31] *See Virginia Electric*, 154 FERC ¶ 61,126.

[32] Golden Spread Limited Protest at 3 (citing *Virginia Electric*, 147 FERC ¶ 61,254 at P 18), 10-11.

[33] Xcel Energy December 15 Answer at 8.

D.2 is to continue compliance with Commission policy to create an average balance for ADIT, and that, as a result of that policy, the calculations in question are therefore necessary to maintain compliance with the IRS's consistency rule. Xcel Energy notes that the IRS concluded that "[f]ailure to average the deferred tax reserve, as prorated, before excluding the reserve from the average rate base will violate the consistency requirement of section 168(i)(9)(B)."[34] Xcel Energy argues that Golden Spread relies on an unsupported and unexplained presumption that proration serves the same function as the beginning of year and end of year averaging, which has been contradicted by the IRS in multiple PLRs.[35]

20. Xcel Energy states that the true-up process cannot be used to unwind the proration calculation of ADIT. According to Xcel Energy, the IRS's view is that forward-looking formula rates with true-up procedures employ a future test period subject to normalization requirements, and such formula rates must use the proration formula in estimating ADIT amounts, including carrying forward the amounts of ADIT calculated using the proration formula into the true-up. Xcel Energy asserts that the IRS has stated that, "[i]n calculating the true-up, proration applies to the original projection amount,"[36] and notes that the originally projected amount is thus carried forward into the true-up, and therefore is not "unwound" by reversing the proration calculation.[37] Xcel Energy explains that the true-up component is determined by reference to a purely historical period and that there is no need to use the proration formula to calculate the differences between projected and actual balances. Xcel Energy contends that Golden Spread's argument would result in a true-up process that reverses the original proration calculation.

21. Xcel Energy asserts that the proration calculation must be applied to appropriate amounts in Account 190 estimated for the projected year. Xcel Energy maintains that deferred tax asset related to the net operating loss in Account 190 is inextricably related to accelerated depreciation, including bonus depreciation,[38] and that the only proposed change related to Account 190 balances in the instant filings is to incorporate the proration

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[34] *Id*. at 9 (citing I.R.S. Priv. Ltr. Rul. 9202029 (Oct. 15, 1991)).

[35] *Id*. at 9-10 (citing I.R.S. Priv. Ltr. Rul. 9202029; I.R.S. Priv. Ltr. Rul. 9224040 (June 12, 1992); I.R.S. Priv. Ltr. Rul. 9313008 (December 17, 1992)).

[36] *Id*. at 11 (citing I.R.S. Priv. Ltr. Rul. 143241-14 at 8).

[37] *Id*. at 12.

[38] *Id*. at 13.

calculation into the projections of these ADIT balances, which is done annually under the SPS transmission formula rate. Xcel Energy states that SPS believes it is reasonable to include all plant-related deferred tax balances used in the determination of rate base when it applies the proration due to the overall lower rates for customers that result. In response to Golden Spread's argument concerning lack of clarity in which Account 190 balances will be subject to proration, Xcel Energy notes that SPS is willing to submit further revisions to its Attachment O to include a footnote stating that "[p]roration is applied to plant related items impacted by Internal Revenue Service rules governing tax normalization."[39]

22. Xcel Energy also notes that the Commission's policy is to set a filing for hearing and settlement judge procedures where the filing raises an issue of material fact that cannot be resolved based on pleadings before the Commission, and, even where there are disputed issues, the Commission need not conduct such a hearing if the issues may be adequately resolved based on the written record.[40] Xcel Energy asserts that the issues raised by Golden Spread concern the proper legal interpretation of IRS regulations, not a material fact that is in dispute between the parties, and therefore neither a hearing nor settlement judge procedures is appropriate. Xcel Energy states that the differences in Xcel Energy's and Golden Spread's positions turn on interpretations of the IRS's requirements, and at stake is the continued eligibility of SPS to use accelerated depreciation.

IV. Deficiency Letter, Response, and Related Pleadings

23. In the Deficiency Letter, Commission staff requested information to aid the Commission in evaluating PSCo's proposed revisions to comply with the IRS regulations by modifying how ADIT is calculated in its transmission and production formula rates. Commission staff requested that PSCo demonstrate the calculation of ADIT using the proration formula for both the estimated amounts of the annual projection and the actual amounts, explain how revising the calculations to conform to IRS regulations is also consistent with the formulas' existing use of average ADIT balances, explain why calculating an ADIT proration factor based on monthly balances is more appropriate than calculating an ADIT proration factor based on daily balances, and explain why the tariff

[39] *Id.* at 14-15.

[40] *Id*. at 16.

revisions contemplated within PSCo's settlement agreement should be accepted within the context of this proceeding.[41]

24. In its Deficiency Response, PSCo submitted hypothetical, illustrative calculations with additional revisions, including changes to the descriptive titles of columns (k), (l), (m), and (n) of the true-up section of Table 8, Workpaper B-2,[42] and revisions to Footnotes 5 and 6 of this section to clarify that PSCo is not proposing to apply the proration calculation to the difference between forecasted and actual amounts.[43] PSCo states that the revisions do not change the intent of the originally-proposed method of calculating the true-up, and that the revised tariff records submitted with the response make corresponding changes to the SPS transmission formula template (Attachment O-SPS) and the PSCo production template. In addition, PSCo also submitted revisions to address Golden Spread's assertions regarding the perceived lack of clarity in which Account 190 balances will be subject to the proration calculation by incorporating an additional footnote into SPS's transmission formula rate template, as discussed in Xcel Energy's Answer.[44]

25. In response to staff's question regarding averaging, PSCo references section 1.167(1)-1(h)(6) of the IRS regulations that requires usage of a proration formula in determining projected ADIT amounts for rate calculation purposes in future test periods, and the "consistency requirement" in Internal Revenue Code section 168(i)(9)(B) that requires application of averaging to the ADIT amounts calculated through proration if the ratemaking methodology employs averaging.[45] PSCo states that the IRS has explained that the proration calculation serves a different purpose than the averaging used in the rate design methodology, and therefore, they are not duplicative calculations. PSCo asserts that the IRS's view on this matter is unambiguous, and has been confirmed on multiple occasions.[46]

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[41] *Pub. Serv. Co. of Colo.*, Deficiency Letter, Docket No. ER16-236-000, *et al.*, at 1 (issued Dec. 23, 2015) (Deficiency Letter).

[42] Deficiency Response at 2.

[43] *Id.* at 3.

[44] *Id.*

[45] *Id.* at 4.

[46] *Id.* at 5 & n.6.

26. PSCo notes that Commission policy requires the use of an average rate base in the calculation of rates, and the Commission's regulations state that ADIT should be calculated as the average of the beginning and end of test year balances.[47] PSCo states that its and SPS's formula rates already reflect the use of beginning and end of test year balances. According to PSCo, in order to comply with both the consistency and proration requirements, PSCo and SPS must apply the beginning-of-year and end-of-year averaging.

27. In response to staff's question on the appropriateness of calculating the proration factor based on monthly balances verses daily balances, PSCo notes that the proration factor for its plant and SPS's plant is calculated based on monthly balances, as required by the Commission's regulations. PSCo asserts that the IRS consistency rules require the calculation of associated ADIT to be consistent, and, therefore, the ADIT proration factor must be based on monthly balances. PSCo states that, since its and SPS's plant is not calculated based on daily balances, calculating the ADIT proration factor based on daily balance would not meet the consistency requirement, and thus PSCo and SPS would not be in compliance with the IRS normalization rules.[48]

28. In response to Commission staff's question on SPS's settlement agreement, PSCo clarifies that revisions to Tables 6 and 11 of Attachment O-SPS contemplated in the settlement agreement in Docket No. EL05-19-000 are not related to ADIT. PSCo explains that the settlement agreement revisions to Note K on Tables 6 and 11 relate to Postretirement Benefits Other Than Pensions expense. PSCo notes that the settlement agreement contained pro forma tariff sheets that included revisions to Tables 6 and 11 of Attachment O-SPS, with an effective date of January 1, 2015, thus predating the revisions proposed in this proceeding.[49]

29. In response, Golden Spread states that it can accept SPS's preferred proration methodology in the projection as an alternative methodology that satisfies the goals of the IRS regulations, but only if SPS calculates the true-up correctly.[50] Golden Spread observes that it and the Commission raised concerns with SPS's proposal to apply a proration in the true-up, notwithstanding the fact that the true-up is performed in a subsequent rate year and

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[47] 18 C.F.R. § 35.13(h)(6) (2015).

[48] Deficiency Response at 8.

[49] *Id*. at 9.

[50] Golden Spread Protest to Deficiency Response at 3 (citing PSCo and SPS Filing, Docket No. ER16-236-000, *et al*., Exh. III (I.R.S. Priv. Ltr. Rul. 143241-14 at 4, 8, 11)).

based on historical, audited data.[51] Golden Spread argues that SPS has not changed this aspect of its rate change proposal and that the continued misapplication of the IRS regulations and PLR guidance results in SPS's proffered formula rate true-up mechanism substantially understating the true-up in a manner that harms customers.[52] Golden Spread states that, under SPS's hypothetical example, the projection in both scenarios would yield a value of $311,555,100.[53] Thus, Golden Spread further points out, SPS would calculate the true-up to yield a value of $349,055,100, or a variance of $37,055,100 from the projection. Under Golden Spread's proposed corrections, the true-up would now yield a value of $362,500,000, or a variance of $50,944,900.[54] Therefore, Golden Spread contends that, if SPS is permitted to prorate the true-up, customers would receive $13.4 million less in credit to rate base. Golden Spread asserts that SPS's proposed Worksheet D amendments are not just and reasonable and are unduly discriminatory and preferential.

30. In its March 21 Answer, Xcel Energy contends that Golden Spread's suggestion in its Limited Protest that the Commission could consider holding this proceeding in abeyance pending the outcome of *Virginia Electric* has been effectively met. Xcel Energy states that, in *Virginia Electric*, the Commission accepted the proposed true-up methodology, which is the same as the methodology proposed in PSCo's filings, and rejected customers' arguments, which were the same arguments raised by Golden Spread.[55] Xcel Energy, however, notes two points in *Virginia Electric* not illustrated in PSCo's and SPS's true-up calculations: (1) when actual ADIT activity is less than projected ADIT activity, but still represents an overall increase in ADIT, the projected ADIT amount would be decreased in the formula rate by the difference between the projected and actual ADIT amounts; and (2) when actual ADIT activity is less than projected ADIT activity, and represents an overall decrease in ADIT, the formula would use the actual decrease in the ADIT value instead of the originally-projected ADIT

[51] *Id*. at 4 (citing Deficiency Letter, Question 1).

[52] *Id*. (citing SPS Worksheet D, Table 19).

[53] *Id*. at 5-8.

[54] *Id*.

[55] Xcel Energy March 21 Answer at 3-4.

amount.[56] Xcel Energy states that PSCo and SPS commit to revise their formula rate templates to incorporate these additional steps upon direction of the Commission.

V. Discussion

A. Procedural Matters

31. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2015), the timely, unopposed motion to intervene of Golden Spread in Docket No. ER16-236 serves to it a party to that proceeding. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2015), we grant Tri-State's, IREA's, and Holy Cross's joint motions to intervene out-of-time in Docket Nos. ER16-236 and ER16-239 given their interests in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay.

32. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R § 385.213(a)(2) (2015), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We accept Xcel Energy's answers because they have provided information that assisted us in our decision-making process.

B. Substantive Matters

33. We find that PSCo's proposed tariff revisions represent a method of compliance with IRS regulations given their current rulings, and we will accept PSCo's filings, subject to the condition that PSCo submit revisions to PSCo's and SPS's formula rate templates, as discussed below.[57] In recent orders, the Commission has clarified that, when a section 205 filing is strictly limited to tax matters, the Commission will base its evaluation on whether "the proposed revisions are reasonable to comply with IRS regulations,"[58] and has

[56] *Id.* at 4-5.

[57] The Commission can revise a proposal filed under section 205 of the FPA as long as the filing utility accepts the change. *See City of Winnfield v. FERC*, 744 F.2d 871, 875-77 (D.C. Cir. 1984). The filing utility is free to indicate that it is unwilling to accede to the Commission's conditions by withdrawing its filing.

[58] *See, e.g., Midcontinent Indep. Transmission Operator, Inc.*, 153 FERC ¶ 61,371, at P 36 (2015) (*MISO*).

expressly rejected the "objection that Private Letter Rulings issued by the IRS cannot be a basis for [] proposed rate revisions."[59]

34. Despite Golden Spread's protests that certain proposed calculations in SPS's Worksheet D unnecessarily average the prorated account balance, and that the initial proration factor creates the average that should be used to comply with IRS regulations, we find that PSCo's methodology is reasonable. PSCo's proposal determines the average rate base by taking the average net plant and subtracting an average of ADIT values. As the IRS indicated in a PLR, "[w]hile there are minor differences in the convention used to average all elements of rate base including depreciation expense on the one hand, and [ADIT] on the other . . . it is sufficient that both are determined by averaging and both are determined over the same period of time."[60] We find that this interpretation also is consistent with the interpretation of other utilities applying the IRS regulations regarding proration.[61]

35. In addition, we dismiss Golden Spread's related protest that SPS performs extra calculations in Worksheet D that skew the appropriate IRS-compliant prorated balance.[62] While Golden Spread makes clear the distinction between how it interprets the method for calculating the average prorated balance and how such a calculation would be made under the proposed tariff revisions for SPS, Golden Spread has not demonstrated that the method proposed by SPS is inconsistent with IRS regulations. In addition, PSCo demonstrates through a hypothetical population that calculating an average prorated balance through an alternative, monthly approach results in the same answer as calculating the average prorated balance through the template method proposed in its tariff revisions.[63] Therefore, we find that PSCo's proposed method for calculating the average ADIT balance is reasonable to comply with the IRS regulations.

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[59] *Id*. P 40.

[60] PSCo, Docket No. ER16-236-000, Transmittal at 3 (citing I.R.S. Priv. Ltr. Rul. 143241-14 at 10).

[61] *See, e.g., Virginia Electric*, 154 FERC ¶ 61,126; *MISO*, 153 FERC ¶ 61,371.

[62] *See* Golden Spread Limited Protest at 4-6.

[63] Deficiency Response at 6-7.

36. While Golden Spread objects to PSCo's proposal to apply the IRS's proration methodology for the originally-projected ADIT amount within the true-up calculation, we also find that this treatment is reasonable to comply with IRS regulations. As the IRS indicated in the PLR included with PSCo's filing, "in calculating the true-up, proration applies to the original projection amount but the actual amount added to the [ADIT] over the test year is not modified by application of the proration formula."[64] Golden Spread's contention that the proposed tariff amendments to the SPS transmission formula rate contradict IRS guidance and harm customers is grounded in an alternative interpretation of language in the cited PLR. However, the fact that the relevant language in the PLR might be susceptible to an alternative interpretation alone does not discount the reasonableness of the interpretation offered by PSCo. Based on the record in this proceeding, we find PSCo's proposed methodology for applying the proration formula to the true-up calculation to be consistent with the methodology approved in *Virginia Electric*, and a reasonable interpretation of the PLR.[65] If the IRS issues further clarifying guidance, it may be considered in future Commission decisions.

37. Further, while we find that PSCo's proposal to revise how ADIT is calculated in the PSCo and SPS formula rates generally conforms to the ADIT-related formula rate revisions accepted by the Commission in *Virginia Electric*, Xcel Energy has acknowledged in its March 21 Answer that certain steps are omitted from PSCo's and SPS's formula rate templates that are necessary to demonstrate how PSCo and SPS will implement the IRS's regulations concerning treatment of ADIT, consistent with *Virginia Electric*.[66] Therefore, we will direct PSCo to submit these additional calculations in a compliance filing to be submitted within 30 days of the date of this order.

38. We further find no merit to Golden Spread's assertions related to whether specific account balances will be subject to the proration requirement. Golden Spread admits that this issue is not readily apparent in proposed changes to the template included in PSCo's filing, and relies on evidence from the "SPS Projection."[67] Here, PSCo proposes to implement revisions to conform its formula rate to a methodology prescribed by the IRS in its regulations, and the issue of how application of these formula revisions applies to SPS's

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[64] PSCo, Docket No. ER16-236-000, Transmittal at 3 (citing I.R.S. Priv. Ltr. Rul. 143241-14 at 8).

[65] *Virginia Electric*, 154 FERC ¶ 61,126.

[66] *Id.*

[67] *See* Golden Spread Limited Protest at 8-9.

projected charges for 2016 is outside the scope of the issues raised in this proceeding. For such objections related to the inputs into the formula rate, Golden Spread may challenge the actual inputs when the annual update of the formula rate is filed. However, in response to Golden Spread's request that SPS be directed to clarify its Worksheet D regarding lack of clarity regarding which account balances will be subject to proration, we note that PSCo voluntarily submitted in its Deficiency Response revisions to SPS's Worksheet D clarifying in a new footnote that "proration is applied to plant related items impacted by Internal Revenue Service rules governing tax normalization."[68] Golden Spread has not protested this revision, and we find this clarification to be a reasonable method to comply with the relevant IRS regulations.

The Commission orders:

(A) PSCo's filings are hereby accepted, subject to condition, effective January 1, 2016, as requested, as discussed in the body of this order.

(B) PSCo is hereby directed to submit a compliance filing within 30 days of the date of this order, as discussed in the body of this order.

By the Commission. Commissioner Clark is not participating.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

[68] Deficiency Response at 2.

Document Content(s)

156 FERC ¶ 61,203
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Cheryl A. LaFleur, Tony Clark,
and Colette D. Honorable.

Midcontinent Independent System Operator, Inc. — Docket No. ER16-197-002

ORDER GRANTING CLARIFICATION

(Issued September 22, 2016)

1. In this order, we grant the motion for clarification by Ameren Services Company, on behalf of Ameren Illinois Company and Ameren Transmission Company of Illinois, (Ameren), and Xcel Energy Services Inc., on behalf of Northern States Power Company, a Minnesota corporation, and Northern States Power Company, a Wisconsin corporation, (NSP Companies), (collectively, Indicated TOs), of the Commission's order issued December 30, 2015.[1]

I. Background

2. On October 30, 2015, Midcontinent Independent System Operator, Inc. (MISO) and certain MISO Transmission Owners (Certain TOs)[2] submitted a filing pursuant to section 205 of the Federal Power Act[3] and part 35 of the Commission's regulations[4] stating that they were proposing to revise Note F of Certain TOs' company-specific

[1] *Midcontinent Indep. Sys. Operator, Inc.*, 153 FERC ¶ 61,371 (2015) (December 30 Order).

[2] The Certain TOs for purposes of the original filing consist of: Ameren; Minnesota Power (and its subsidiary Superior Water, L&P); Montana-Dakota Utilities Co.; Northern Indiana Public Service Company; NSP Companies; Otter Tail Power Company; and Southern Indiana Gas & Electric Company (d/b/a Vectren Energy Delivery of Indiana).

[3] 16 U.S.C. § 824d (2012).

[4] 18 C.F.R. pt. 35 (2016).

Attachments O formula rates in the MISO Open Access Transmission, Energy and Operating Reserve Markets Tariff (Tariff) to clarify that they would calculate the Accumulated Deferred Income Tax (ADIT) balances used in the calculation of the projected test year revenue requirement using the proration methodology in order to comply with section 1.167(l)-1(h)(6)(ii) of the United States Internal Revenue Service (IRS) regulations. The IRS has issued a series of Private Letter Rulings addressing how the ADIT provisions apply to utilities that use a projected test year. In the Private Letter Rulings, the IRS has found that, in order to claim accelerated depreciation for utility plant in their income tax filings, utilities using a projected test year must use the formula provided in the IRS regulations.[5] According to MISO and Certain TOs, if the IRS were to rule that Certain TOs were out of compliance with the IRS regulations, they would be ineligible to claim accelerated depreciation, which could result, initially, in a rate increase for customers.

3. In the December 30 Order, the Commission conditionally accepted the proposed revisions to Certain TOs' company-specific Attachments O formula rates. The revisions became effective on January 1, 2016, as requested. The Commission determined that the proposed revisions to Note F to apply the IRS regulations to the annual projected ADIT amounts were reasonable, but the Commission ordered a subset of the Certain TOs (the Indicated TOs in the instant filing) to remove the application of the IRS regulations to the annual true-up ADIT amounts.[6] With respect to the proposed true-up procedures of Indicated TOs, the Commission reasoned that the Indicated TOs had not justified those proposed revisions as just and reasonable. The Commission determined that the guidance in the Private Letter Rulings does not require any changes in calculating the true-up amounts, and the Indicated TOs' filing did not contain any rationale as to why the proposed revisions are needed for the annual true-up.[7]

4. On January 29, 2016, MISO and Certain TOs submitted revisions to their company-specific Attachments O to comply with the December 30 Order, which reflected the removal of the application of the IRS regulations to the annual true-up ADIT amounts. The Commission is accepting the compliance filing in a separate order issued concurrently herewith.

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[5] *See* I.R.S. P.L.R. 14324114 (Jul. 6, 2015), https://www.irs.gov/pub/irs-wd/201541010.pdf; I.R.S. P.L.R. 14012014 (Apr. 14, 2015), https://www.irs.gov/pub/irs-wd/201531010.pdf.

[6] The projected revenue requirement under Attachment O is subject to an annual true-up based on actual costs when actual data becomes available.

[7] *See* December 30 Order, 153 FERC ¶ 61,371 at P 38.

II. Request for Clarification

5. On January 29, 2016, Indicated TOs filed a request for clarification or, in the alternative, rehearing of the December 30 Order. Indicated TOs request the Commission to clarify that, should the IRS rule that the proration methodology described in Section 1.167(l)-(1)(h)(6)(ii) of the Treasury regulations must continue to be applied to the originally projected ADIT balances in performing the annual formula rate true-up calculations, Indicated TOs are not estopped by the December 30 Order from making a future filing with the Commission consistent with the IRS's direction.

III. Procedural Motions

6. On March 11, 2016, Indicated TOs filed a motion to lodge the Commission's February 23, 2016 order in *PJM Interconnection, L.L.C.*[8] Indicated TOs argue that the Commission should grant the motion to lodge because the December 30 Order is contrary to *PJM*. Indicated TOs further assert that the Commission's reasoning in *PJM* is consistent with Indicated TOs' explanation for their proposal to apply the proration methodology to the originally projected ADIT amount in calculating the true-up.

7. Also on March 11, 2016, Indicated TOs filed a motion for reconsideration of the December 30 Order. Indicated TOs argue that the December 30 Order is inconsistent with *PJM* to the extent it prohibits Ameren from applying the IRS's proration methodology in calculating the true-up. Indicated TOs further assert that the calculations contained in Ameren's revised ADIT work papers mirror those of the filing party in *PJM*, which the Commission accepted as just and reasonable.

8. On August 2, 2016, Indicated TOs filed a motion to lodge the Commission's April 12, 2016 order in *Pub. Serv. Co. of Colorado*,[9] as well as another motion for reconsideration of the December 30 Order. Indicated TOs argue that the Commission should grant the motion to lodge because *PSCo* is contrary to the December 30 Order. Indicated TOs further assert that the proration methodology accepted in *PSCo* is the same methodology for which Indicated TOs sought approval to use in calculating their Attachment O rates, and which the Commission rejected.

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[8] 154 FERC ¶ 61,126 (2016) (*PJM*).

[9] 155 FERC ¶ 61,028 (2016) (*PSCo*).

9. On August 23, 2016, Joint Consumer Advocates[10] filed a motion to intervene out-of-time and comments opposing the motions to lodge and motions for reconsideration of Indicated TOs. Joint Consumer Advocates recommend that the Commission not allow any ADIT proration, but that at a minimum if the Commission allows ADIT proration, that the Commission require a true-up once actual amounts are known, so that ADIT proration is only a timing issue and not a permanent overcharging of ratepayers. Joint Consumer Advocates present various arguments justifying why the Commission should deny Indicated TOs' motions, ranging from the violation of conventional ratemaking accounting principles and the potential negative effect on ratepayers, to the limited precedential value of IRS Private Letter Rulings as applied to other entities and the Commission's primary jurisdiction regarding utility accounting matters.

10. On September 2, 2016, the Organization of MISO States filed a motion to intervene out-of-time.

IV. Discussion

A. Request for Clarification

11. We grant the motion for clarification by Indicated TOs. Indicated TOs specifically ask that we clarify that should the IRS rule that the proration methodology described in the Treasury regulations[11] must continue to be applied to the originally projected ADIT balances in performing the annual formula rate true-up calculations, Indicated TOs are not estopped by the December 30 Order from making a future filing with the Commission consistent with the IRS's direction.[12] We clarify that Indicated TOs are not estopped from making a future filing.

B. Procedural Motions

12. We deny Indicated TOs' motions to lodge. Given that the Commission has knowledge of its own holdings, we find a motion to lodge prior Commission orders is

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[10] Joint Consumer Advocates consist of The Illinois Citizens Utility Board, the Indiana Office of Utility Consumer Counselor, the Iowa Office of Consumer Advocate, the Michigan Citizens Against Rate Excess, the Minnesota Department of Commerce, the Minnesota Attorney General's Office, the Missouri Office of the Public Counsel, and the Citizens Utility Board of Wisconsin.

[11] *See* Treas. Reg. § 1.167(l)-1(h)(6)(ii).

[12] We do not act on Indicated TOs' alternative request for rehearing because we grant their request for clarification.

unnecessary.[13] We also deny Indicated TOs' subsequent motions for reconsideration. The cases Indicated TOs cite do not change the fact that, although the Attachment O formula submitted with Indicated TOs' initial filing reflected proration applying to the ADIT true-up, Indicated TOs did not in their transmittal specifically request that proration be applied to the ADIT true-up, nor did they explain why the change to the calculation of the true-up was required by the IRS regulations.[14] It is not appropriate to attempt to add additional requests for relief in a motion for reconsideration after the issuance of the Commission order on the filing. The Commission has long held that it will reject new arguments on rehearing that could have been but were not advanced originally.[15] Similarly, it is not appropriate to raise new requests for relief in a motion for reconsideration. Indeed, Indicated TOs acknowledge in their request for clarification that they did not explicitly request that the proration methodology be used for the true-up. [16]

13. When late intervention is sought after the issuance of a dispositive order, the prejudice to other parties and burden upon the Commission of granting the late intervention may be substantial. Thus, movants bear a higher burden to demonstrate good cause for granting such late intervention. Joint Consumer Advocates and the Organization of MISO States have not met this higher burden of justifying their late intervention.[17]

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[13] *Midwest Indep. Transmission Sys. Operator, Inc.*, 153 FERC ¶ 61,114 (2015) (citing *La. Pub. Serv. Comm'n v. Entergy Servs., Inc.*, 146 FERC ¶ 61,152, at P 13 (2014)).

[14] October 30, 2015 Transmittal at 4.

[15] *See, e.g., Algonquin Gas Transmission, LLC*, 154 FERC ¶ 61,048, at P 250 (2016) (explaining that novel issues raised on rehearing are rejected "because our regulations preclude other parties from responding to a request for rehearing and such behavior is disruptive to the administrative process because it has the effect of moving the target for parties seeking a final administrative decision") (internal quotations omitted).

[16] *See* Indicated TOs' Request for Clarification at P 7.

[17] *See, e.g., Midwest Indep. Transmission Sys. Operator, Inc.*, 102 FERC ¶ 61,250, at P 7 (2003).

The Commission orders:

Indicated TOs' request for clarification is hereby granted, and their motions to lodge and for reconsideration are denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

Document Content(s)

CERTIFICATE OF SERVICE

I, Carl Cronin, hereby certify that I have this day served copies of the foregoing document on the attached list of persons.

xx by depositing a true and correct copy thereof, properly enveloped with postage paid in the United States mail at Minneapolis, Minnesota

xx electronic filing

DOCKET NO. E002/M-15-891

Dated this 29th day of September 2016

/s/

_____

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