MINNESOTA DEPARTMENT OF COMMERCE

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November 7, 2016

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 300
St. Paul, Minnesota 55101

RE: **Additional Response Comments of the Minnesota Department of Commerce, Division of Energy Resources to the Response Comments of Northern States Power Company**
Docket No. E002/M-15-891

Dear Mr. Wolf:

On September 29, 2016, Northern States Power Company d/b/a Xcel Energy (Xcel or the Company) filed its response to the Department's September 7, 2016 Response Comments.

Attached please find the Minnesota Department of Commerce, Division of Energy Resources' (Department) Additional Response Comments to the September 29, 2016 Response Comments of Northern States Power Company, doing business as Xcel Energy (Xcel).

The Department does not agree with Xcel that Internal Revenue Service (IRS) regulations require proration of Accumulated Deferred Income Taxes (ADIT); further, the Department does not support the use of prorated ADIT for riders as discussed in more detail below. As a result, **the Department recommends the Commission deny the Company's request for the proration of ADIT.**

However, for purposes of resolving this issue and not using limited state resources, **the Department's alternative recommendation is to:**

1) allow the prorated ADIT only for recovery of forecasted costs (costs that are not historical, actual costs at the time the rates go into effect) and,
2) require a true-up in the following year (once all amounts are historical/actual) by using actual non-prorated ADIT amounts.

Finally, if Xcel continues to pursue this issue to the detriment of ratepayers, **the Department recommends that the Commission consider either denying rider recovery or limiting rider recovery to historical costs, as both of these approaches would eliminate the need to prorate ADIT balances.**

Xcel's proposal would charge ratepayers for more than the costs of a utility-owned facility over the life of the plant, by never returning to ratepayers the prepaid income taxes that ratepayers provided to the utility in early years of a facility's life.[1] The Department's alternative proposal would allow Xcel to keep the prepaid income taxes only temporarily and only for any forecasted costs; Xcel would have to refund the overcharge in the subsequent year. That is, the Department's alternative proposal would be a timing issue, where ratepayers would receive refunds soon after prepaying Xcel's income taxes, as opposed to Xcel's proposal to overcharge ratepayers by keeping the prepaid taxes and never refunding the money to ratepayers, thus charging ratepayers for more than the cost of the utility-owned facility.

Prepaid taxes are recognized in the Accumulated Deferring Income Taxes (ADIT) rate base account; ADIT is an offset to rate base, and thus reduces the costs charged to ratepayers. Prorating the ADIT account, for forecasted costs, reduces the rate base credit to ratepayers. Under the Department's alternative proposal, Xcel would give ratepayers a reduced prorated ADIT credit amount for forecasted costs in the forecasted year, but require a true-up to actual non-prorated ADIT in the following year when amounts are historical/actual. This true-up restores to ratepayers the amount by which they have prepaid Xcel's income taxes in the prior year, which would then be consistent with past practice. By contrast, Xcel's request to allow pro-ration of ADIT but defer the decision to require a true-up is unreasonable and one-sided to the benefit of Xcel and would harm ratepayers.

Prorated ADIT

The Department provides the following reasons for why the Company should not be allowed to prorate its ADIT credits:

- First, Private Letter Rulings (PLRs) are not the same as IRS Regulations and every PLR states that they are only allowed to be used by the entity requesting the PLR and may not be used or cited as precedent.

- Second, providing ratepayers with an ADIT credit for rate base equal to the deferred tax expense that ratepayers are prepaying is a long-standing ratemaking policy.

- Third, under Xcel's proposal, debits and credits would no longer be equal, which violates a foundation accounting rule. The debit is to deferred income tax

[1] In the early years of a facility's life, accelerated depreciation allowed under IRS rules results in higher depreciation expense, and thus lower income taxes, compared to uniform depreciation under ratemaking. Under normal ratemaking, the costs will even out over the like of the plant. However, under Xcel's proposal, ratepayers would be permanently harmed by never getting back the prepaid income taxes from the early life of the facility.

expense, which the Company still plans to fully charge customers, yet the ADIT credit would be reduced because of the proration, thus causing an inequity.

- Fourth, Xcel is not incurring any additional costs to warrant such a change in this long-standing ratemaking policy; in fact utilities are paying less income tax that ever due to bonus tax legislation. Thus, increasing costs to ratepayers is unsupported. (Note providing an ADIT credit equal to the deferred tax expense is no different than ratepayers paying depreciation expense and then getting the same amount as a reduction to rate base through accumulated depreciation.)

- Fifth, all components of forecasted rate base are calculated using an average of non-prorated beginning and end-of-year balances (average rate base). Thus, allowing the ADIT credit to be calculated on a prorated basis would result in an inconsistent treatment of rate base calculations and therefore would not be reasonable without adequate support for such a difference in accounting and ratemaking.

The Department would also like to address in more detail two new issues raised by the Company: 1) Private Letter Ruling Used as Guidance and 2) Recent Orders by the Federal Energy Regulatory Commission (FERC) Regarding Prorated ADIT.

Private Letter Ruling Used as Guidance

Regarding PLRs, the Department notes that Xcel on page 1 of its September 29, 2016 Response Comments stated that "IRS Regulations Require Proration" yet on page 6 Xcel stated "Private Letter Rulings Can and Should Be Used as Guidance." The Department considers "guidance" as significantly less requisite than Xcel's claim that proration is "required by the IRS".

Additionally, the Company referred on page 6 of its September 29, 2016 Response Comments to a Supreme Court Case from 1962 (*Hanover Bank v. Commissioner*) that the Company argued provided a basis for Xcel's broad and not specific citation that PLRs "reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws." The Department, however, provides the complete quotation here:

> Furthermore, although **the petitioners are not entitled to rely upon unpublished private rulings which were not issued specifically to them**, such rulings do reveal the interpretation put upon the statute by the agency charged with administering the revenue laws. (Emphasis added)

Hanover Bank v. Comm'n of Internal Rev., 369 U.S. 672, 686 (1962). Thus, the U.S. Supreme Court was relying on its own construction of federal tax law, and referred to private letter rulings as only supporting text. Moreover, the Department provides additional understanding of the legal analysis regarding PLRs:

Under the Code, an exception to the general rule that PLRs may not generally be relied upon as precedent exists if the IRS, by Regulations, determines that a particular PLR will be precedential. *See* 26 U.S.C. § 6110(k)(3) (2012). This view was confirmed in a recent United States Court of Federal Claims decision, which stated that "[m]ost courts, therefore, do not find private letter rulings, issued to other taxpayers, to be of precedential value in deciding the tax claims before them." *Amergen Energy Co., LLC v. U.S.*, 94 Fed. Cl. 413, 418 (Fed. Cl. 2010).

The Federal Claims Court, applying its decision in *Vons Cos. v. United States*, 51 Fed. Cl. 1 (Fed. Cl. 2001), summarized permissible uses of PLRs: "PLRS may be used as evidence of administrative practice of the IRS, and may, in certain circumstances, be used in abuse of discretion cases governed by *IBM*." *Id.* at 419. But, the court concluded that PLRs may not be used "for their substance or for their value in interpreting the I.R.C. . . ." *Id.* at 419–20.

The court also rejected the plaintiff's reliance on the *Oshkosh* case, stating: "The lesson of *Oshkosh* is that 'drawing an arbitrary distinction between similarly-situated taxpayers' may not survive judicial review . . . if the distinction is not supported by the Code. Oshkosh nowhere discusses private letter rulings . . . ." *Id.* at 421 (citing *Florida Power & Light Co. v. U.S.*, 375 F.3d 1119, 1125 n.13 (Fed. Cir. 2004)). The court went on: "If plaintiff is entitled to the tax treatment it requests in this suit, that entitlement will come from the Code, not from a comparison with private letter rulings issued by the IRS." *Id.* (citing *Oshkosh Truck Corp. v. U.S.*, 123 F.3d 1477, 1481 (Fed. Cir. 1997)).

Thus, Xcel's contention as to the reasonableness of its proposal to prorate ADIT or as to whether it would commit a normalization violation if it did not prorate ADIT must stem from the Code, not PLRs, which Xcel has not demonstrated. Moreover, it appears that the Internal Revenue Manual (IRM) that Xcel cites may merely be referring to the exception to the general rule under § 6110(k)(3) that PLRs are not precedential unless "codified" under Treasury Regulations. The Department is not aware that the IRS has specifically determined that any PLRs that Xcel refers to have been made precedential under the law.

On pages 8-10 of its September 29 Response Comments, Xcel claims that maintaining the proration in the true-up to actuals is required; that is, Xcel claims that the IRS requires Xcel to keep for its shareholders the prepaid income taxes provided by ratepayers, even after the test year has passed and actual costs are known. Further, Xcel claimed that the DOC misinterpreted the PricewaterhouseCoopers (PwC) article in the manner for which it was intended with regards to the ADIT proration at true-up. Moreover, Xcel claimed that the IRS's fifth PLR (PLR No. 201541010) supports the Company's proposal to continue proration in the true-up calculations.

The DOC respectfully disagrees. The Department notes that there are two figures required for a true-up: the first figure is the amount actually collected in rates based on the forecasted prorated ADIT; the second figure is the actual/historical non-prorated ADIT amount. The difference between these figures would be reflected in the true-up calculations. In fact, PLR No. 201541010 supports the DOC's proposal to use actual/historical non-prorated ADIT amounts in the true-up calculations. PLR No. 201541010 stated in Conclusion No. 3 that:

> 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.**[2] (Emphasis added)

Recent FERC Orders Regarding Prorated ADIT

Beginning on page 10 of its September 29, 2016 Response Comments, Xcel discussed several recent FERC Orders regarding Prorated ADIT (provided as Attachments C, D, E, and F to the Company's filing). The Department notes that for 2016 all of the MISO transmission owners that had forecasted revenue requirements, including Xcel and Ameren, were allowed to use prorated ADIT for forecasted costs *but were required to use non prorated ADIT balances for purposes of the true-up* (once amounts become actual/historical). The Department notes that only Xcel and Ameren (of the MISO transmission owners) are taking an aggressive tax position and requesting that they be allowed to continue prorating ADIT amounts for true-up purposes, which results in permanent tax differences that harms ratepayers.

FERC denied Xcel and Ameren's request to prorate ADIT amounts for true-up purposes in their 2016 transmission rates, but left the door open for Xcel and Ameren to again request and support their position in future filings. As noted above, the Department considers the continued pro-ration for true-up purposes once amounts become actual to be inconsistent with the 5th PLR. Additionally, utilities are not incurring additional tax costs (and are actually paying less than ever)[3] yet they are proposing to unfairly reduce the ADIT credit provided ratepayers (so it is no longer equal to deferred income tax expense ratepayers continue to pay).

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[2] Per Xcel's September 29, 2016 Response Comments in Docket No. E002/M-15-891; Attachment B, Page 53 of 54.

[3] DOC notes that Xcel Energy has paid less than $1 million in total federal incomes taxes from 2009 to 2015 per the Company's response to DOC information request no. 1168 in Docket No. E002/GR-15-826 (discussed on page 22 of Campbell Direct).

On November 3, 2016, Xcel made an additional filing at FERC to support their continued ADIT proration for true-up purposes.[4] The Department notes that we intend to file comments at FERC opposing Xcel's ADIT proration proposal for true-up purposes. However, despite this activity at FERC, the Department recommends that the Commission make its own decision based on the facts of ADIT proration in Minnesota cases and avoid a bad policy decision which would negatively impact ratepayers if ADIT prorate is allowed for true-up purposes.

Finally, if Xcel continues to pursue this issue to the detriment of ratepayers, the Department recommends that the Commission consider either denying rider recovery or limiting rider recovery to historical costs, as both of these approaches would eliminate the need to prorate ADIT balances.

Sincerely,

/s/ MARK JOHNSON
Financial Analyst

/s/ NANCY A. CAMPBELL
Financial Analyst

MJ/NAC/ja

[4] Docket No. ER17-305-000.

CERTIFICATE OF SERVICE

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

Minnesota Department of Commerce
Additional Response Comments

Docket No. E002/M-15-891

Dated this 7th day of November 2016

/s/Sharon Ferguson

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