STATE OF CALIFORNIA **GAVIN NEWSOM,** *Governor*

PUBLIC UTILITIES COMMISSION
505 Van Ness Avenue
San Francisco CA 94102-3298

Southern California Gas Company
GAS (Corp ID 904)
Status of Advice Letter 6018G
As of November 15, 2022

Subject: Adjustment to Revenue Requirement in Accordance with Internal Revenue Service Private Letter Ruling

Division Assigned: Energy

Date Filed: 08-12-2022

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Resolution Required: No

Resolution Number: None

Commission Meeting Date: None

CPUC Contact Information:

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STATE OF CALIFORNIA **GAVIN NEWSOM,** *Governor*

PUBLIC UTILITIES COMMISSION
505 Van Ness Avenue
San Francisco CA 94102-3298

To: Energy Company Filing Advice Letter

From: Energy Division PAL Coordinator

Subject: Your Advice Letter Filing

The Energy Division of the California Public Utilities Commission has processed your recent Advice Letter (AL) filing and is returning an AL status certificate for your records.

The AL status certificate indicates:

Advice Letter Number
Name of Filer
CPUC Corporate ID number of Filer
Subject of Filing
Date Filed
Disposition of Filing (Accepted, Rejected, Withdrawn, etc.)
Effective Date of Filing
Other Miscellaneous Information (e.g., Resolution, if applicable, etc.)

The Energy Division has made no changes to your copy of the Advice Letter Filing; please review your Advice Letter Filing with the information contained in the AL status certificate, and update your Advice Letter and tariff records accordingly.

All inquiries to the California Public Utilities Commission on the status of your Advice Letter Filing will be answered by Energy Division staff based on the information contained in the Energy Division's PAL database from which the AL status certificate is generated. If you have any questions on this matter please contact the:

Energy Division's Tariff Unit by e-mail to
edtariffunit@cpuc.ca.gov

Joseph Mock
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Regulatory Affairs

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August 12, 2022

Advice No. 6018
(U 904 G)

Public Utilities Commission of the State of California

Subject: Adjustment to Revenue Requirement in Accordance with Internal Revenue Service Private Letter Ruling

Southern California Gas Company (SoCalGas) hereby submits for approval with the California Public Utilities Commission (Commission or CPUC) revisions to SoCalGas's revenue requirement.

Purpose

SoCalGas seeks to adjust its revenue requirement in compliance with the findings of the Internal Revenue Service (IRS) regarding whether to include or exclude certain costs from the Average Rate Assumption Method (ARAM) calculation, so as to be consistent with the IRS's tax normalization rules. This adjustment is made in accordance with Ordering paragraph (OP) 21 of the Test Year 2019 General Rate Case (GRC) Decision of SoCalGas and San Diego Gas & Electric Company (2019 GRC Decision). SoCalGas also proposes to consolidate this adjustment with an overcollection related to 2018 income tax savings.

Background

The Tax Cuts and Jobs Act (TCJA) was enacted on December 22, 2017.[1] The TCJA made comprehensive changes to federal tax law that affected both individuals and corporations. The TCJA also included provisions specific to regulated utilities such as SoCalGas. Most of the changes to federal tax law under the TCJA became effective beginning on January 1, 2018.[2] The most significant change under the TCJA for corporations generally, and for regulated utility corporations specifically, was the lowering of the federal corporate tax rate from 35% to 21% beginning in 2018. Another TCJA-related change affecting SoCalGas was a requirement to return plant-related excess accumulated deferred federal income taxes

[1] Pub. L. No. 115-97, 131 Stat. 2054 (2017).
[2] Certain changes related to bonus depreciation became effective on September 28, 2017.

(ADFIT) created by the reduction in the corporate tax rate to ratepayers ratably using ARAM as described in the TCJA.

SoCalGas has begun the process of returning the excess ADFIT to its customers. But in doing so, SoCalGas must adhere to the timing rules and other requirements under the TCJA. Failure to follow these rules and procedures will result in a normalization violation.[3] The TCJA specifies that utilities may not return the excess ADFIT associated with utility plant assets (excess plant-based ADFIT) more rapidly than ratably over the regulatory life of the underlying assets.[4] Specifically, utilities are generally not permitted, in computing costs of service for ratemaking purposes, to refund excess plant-based ADFIT more rapidly or greater than the reductions permitted by the ARAM approach, which requires amortization of the excess tax reserve over the remaining regulatory lives of the property that gave rise to the ADFIT.[5] The TCJA defines ARAM as follows:

> The average rate assumption method is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes. Under such method, during the time period in which the timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying – (i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by (ii) the amount of the timing differences which reverse during such period.[6]

The requirement to use ARAM applies only to excess deferred taxes on plant-based assets that are subject to the IRS normalization rules (also known as “protected” assets). If a utility’s books and records do not contain the vintage data necessary to apply ARAM, the TCJA allows the utility to use an alternative method that amortizes the excess plant-based ADFIT ratably over the remaining average life or composite rate used to compute depreciation for regulatory purposes.[7]

In the 2019 GRC Decision, among the TCJA impacts, the CPUC considered the proper computation of ARAM—specifically, when computing the ARAM (as per TCJA section 13001(d)(3)(B)), whether the cost of removal should be included or excluded from book depreciation in the ARAM calculation.[8] Ultimately, the CPUC and SoCalGas disagreed on the inclusion of cost of removal in the ARAM calculation. SoCalGas’s position was that, to be consistent with the normalization rules, cost of removal should be excluded from the ARAM computation. However, the CPUC concluded that unless otherwise directed by the IRS, SoCalGas should not exclude cost of removal from the ARAM computation. Specifically, the 2019 GRC Decision includes the following analysis and conclusion from the CPUC:

> The IRS does not provide sufficient ARAM guidance regarding whether SoCalGas’ adjustment concerning removal costs is appropriate, but we find that excluding costs of removal has the effect of delaying the refund to

[3] TCJA Section 13001(d)(4).
[4] TCJA Section 13001(d)(1).
[5] TCJA Section 13001(d)(3)(B).
[6] TCJA Section 13001(d)(3)(B).
[7] TCJA Section 13001(d)(3)(C). SoCalGas has the vintage data needed to compute ARAM and thus does not fall within this exception.
[8] “Cost of removal” is the cost of demolishing, dismantling, tearing down, or otherwise removing electric or gas plant, including incidental transportation and handling costs.

> ratepayers as compared to not applying this adjustment. This is because the ARAM calculation compares accelerated depreciation to book depreciation and when there is reduced book depreciation (due to excluding cost of removal), there is less total ARAM return of excess ADIT. Absent clear guidance from the IRS, we find it more reasonable to disallow this adjustment as we do not believe that this violates the IRS normalization rules concerning return of excess ADIT in the TCJA and so as not to delay the refund to ratepayers.[9]

Accordingly, the CPUC's methodology results in a larger amount of book depreciation in all years (and a more rapid return of excess ADFIT to customers).

Notwithstanding the CPUC's determination, the Commission found it "prudent and reasonable to allow SoCalGas to track the revenue requirement difference between including and excluding cost of removal from the ARAM calculation," and to allow SoCalGas to seek recovery of such difference in the event the IRS issues a ruling or releases further guidance indicating that cost of removal should be excluded from the ARAM calculation.[10] In such case, the CPUC stated that SoCalGas "should seek recovery of any difference in costs by filing a Tier 2 advice letter seeking appropriate adjustment to its revenue requirement."[11]

Pursuant to Advice Letter 5546, effective January 1, 2020, SoCalGas is tracking the revenue requirement differences between including and excluding the cost of removal from the ARAM calculation, as directed by the CPUC in the 2019 GRC Decision.

Discussion

On October 8, 2021, SoCalGas filed a Private Letter Ruling (PLR) request with the IRS National Office, requesting clarification on the ARAM calculation methodology. SoCalGas requested the following rulings from the IRS in its request:

1. Whether the CPUC's method of including book cost of removal in the ARAM calculation for the return of excess deferred taxes to ratepayers is inconsistent with the normalization rules.
2. Whether the method proposed by SoCalGas of excluding book cost of removal in the ARAM calculation for the return of excess deferred taxes to ratepayers is consistent with the normalization rules.
3. Whether SoCalGas's use of the method proposed by the CPUC, as required by the 2019 GRC Decision, will not be a violation of the normalization rules, provided the CPUC (i) approves the method proposed by SoCalGas (or otherwise required by the IRS) and (ii) allows SoCalGas to recover any difference in the rates charged to customers under the CPUC's proposed method and SoCalGas's method under the procedures for such recovery as set forth in the 2019 GRC Decision.

On May 1, 2022, the IRS issued its PLR to SoCalGas, reaching a different conclusion than D.19-09-051.[12] Specifically, the IRS concluded that:

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[9] D.19-09-051, at 637-638.
[10] D.19-09-051, at 638.
[11] D.19-09-051, at 638.
[12] PLR-122708-21.

1. The CPUC's method of including book cost of removal in the ARAM calculation for the return of excess deferred taxes to ratepayers is inconsistent with the normalization rules.
2. The method proposed by SoCalGas of excluding book cost of removal in the ARAM calculation for the return of excess deferred taxes to ratepayers is consistent with the normalization rules.
3. SoCalGas's use of the method proposed by the CPUC, as reflected in the 2019 GRC Decision, is not a violation of the normalization rules, provided that the Commission: (i) approves the method proposed by SoCalGas (or otherwise required by the IRS); and (ii) allows SoCalGas to recover any difference in the rates charged to customers under the Commission's proposed method and SoCalGas's method.

Accordingly, based on the above IRS findings, SoCalGas files this advice letter to adjust its revenue requirement authorized in the 2019 GRC Decision. The adjustment to SoCalGas's revenue requirement is comprised of the difference between excluding and including book cost of removal in the ARAM calculation for the 2018 – 2023 period,[13] partially offset by the revenue impact of the corresponding adjustments to reduce rate base for the decrease in the ARAM amortization amounts for those years. The total adjustment that SoCalGas is requesting to collect in this Tier 2 filing is $55.528 million (excluding interest). The calculation of the adjustment is reflected in the following table, which shows the incremental revenue effect by year for 2018 – 2023. Positive numbers indicate an increase to the revenue requirement, and negative numbers indicate a decrease to the revenue requirement.

[13] The CPUC in the 2019 GRC Decision ordered SoCalGas to file a Tier 2 Advice Letter to adjust its 2018 revenue requirement in order to reflect the TCJA's impact on 2018 rates. *See* D.19-09-051, OP 22, at 781. In accordance with the CPUC's order, SoCalGas filed AL 5541 on October 31, 2019. Among the adjustments reflected in the advice letter was a calculation of ARAM with book cost of removal included, consistent with the CPUC's determination in the 2019 GRC Decision. *See* AL 5541, at 2. The CPUC approved AL 5541 on December 17, 2019, with an effective date of January 1, 2020. Accordingly, the 2018 revenue requirement should be adjusted to be consistent with the IRS's conclusions in SoCalGas's PLR so as to prevent a normalization violation related to the ARAM calculation, just as for the 2019-2023 years.

SoCalGas			
Revenue Impact of Excluding vs Including Book Accruals for Cost of Removal (COR) in ARAM Calculation			
2018 - 2023			
($ amounts in thousands)			
	Revenue Impact of Excluding COR (SoCalGas's Method)	Revenue Impact of Including COR (CPUC's Method)	Revenue Impact of Difference Between the Methods
2018 Impact of Including Book Accruals for COR in ARAM Amortization	(15,519)	(26,627)	11,108
2018 Rate Base Impact of 2018 ARAM Amortization Adjustment	(754)	-	(754)
2019 Impact of Including Book Accruals for COR in ARAM Amortization	(16,527)	(28,810)	12,284
2019 Rate Base Impact of 2018 - 2019 ARAM Amortization Adjustments	(1,588)	-	(1,588)
2020 Impact of Including Book Accruals for COR in ARAM Amortization	(16,527)	(28,810)	12,284
2020 Rate Base Impact of 2018 - 2020 ARAM Amortization Adjustments	(2,418)	-	(2,418)
2021 Impact of Including Book Accruals for COR in ARAM Amortization	(16,527)	(28,810)	12,284
2021 Rate Base Impact of 2018 - 2021 ARAM Amortization Adjustments	(3,249)	-	(3,249)
2022 Impact of Including Book Accruals for COR in ARAM Amortization	(16,527)	(28,810)	12,284
2022 Rate Base Impact of 2018 - 2022 ARAM Amortization Adjustments	(4,079)	-	(4,079)
2023 Impact of Including Book Accruals for COR in ARAM Amortization	(16,527)	(28,810)	12,284
2023 Rate Base Impact of 2018 - 2023 ARAM Amortization Adjustments	(4,909)	-	(4,909)
Total Revenue Impact of Differences (2018 - 2023)			**55,528**

With estimated interest of $1.665 million, the total ARAM-related adjustment is $57.193 million. Please note that the ARAM forecasts included in SoCalGas's pending Test Year 2024 GRC[14] have excluded book cost of removal from the ARAM calculation, consistent with the IRS's conclusions.

In addition to the above, as of December 31, 2021, SoCalGas has an overcollection associated with the 2018 TCJA savings. While the 2018 TCJA savings were refunded to customers in connection with AL 5541, an overcollection of $1.278 million including interest remains. SoCalGas proposes to refund the remaining amount, with interest, to customers.

Amortization of Revised Revenue Requirement in Rates

SoCalGas respectfully proposes to adjust base margin by $55.915 million ($57.193 million undercollection related to the PLR including estimated interest partially offset by $1.278 million overcollection related to the remaining 2018 TCJA savings). SoCalGas requests this amount be collected over a 12-month period beginning in January 2023. SoCalGas will transfer any residual balances that remain upon amortization to its Core Fixed Cost Account and Non-Core Fixed Cost Account. Upon approval of this advice letter, SoCalGas will implement this adjustment as part of its year-end consolidated advice letter.

Attachments

Included with this submittal as Attachment A is PLR 122708-21, which is SoCalGas's PLR on the cost of removal/ARAM issue.

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[14] Application (A.) 22-05-015/-016 (cons.).

Protests

Anyone may protest this Advice Letter to the Commission. The protest must state the grounds upon which it is based, including such items as financial and service impact, and should be submitted expeditiously. The protest must be submitted electronically and must be received within 20 days after the date of this Advice Letter, which is September 1, 2022. Protests should be submitted to the attention of the Energy Division Tariff Unit at:

E-mail: EDTariffUnit@cpuc.ca.gov

In addition, protests and all other correspondence regarding this Advice Letter should also be sent electronically to the attention of:

Attn: Gary Lenart
Regulatory Tariff Manager
E-mail: GLenart@socalgas.com
E-mail: Tariffs@socalgas.com

Effective Date

SoCalGas asserts this submittal is subject to Energy Division disposition and should be classified as Tier 2 (effective after staff approval) pursuant to General Order (GO) 96-B. SoCalGas respectfully requests that this submittal become effective September 11, 2022, which is 30 calendar days after the date submitted.

Notice

A copy of this Advice Letter is being sent to SoCalGas's GO 96-B service list and the Commission's service lists in A.17-10-007/-008 (cons.) and A.22-05-015/-016 (cons.). Address change requests to the GO 96-B service list should be directed via e-mail to Tariffs@socalgas.com or call 213-244-2837. For changes to all other service lists, please contact the Commission's Process Office at 415-703-2021 or via e-mail at Process_office@cpuc.ca.gov.

/s/ Joseph Mock
Joseph Mock
Director – Regulatory Affairs

Attachments

California Public Utilities Commission

ADVICE LETTER SUMMARY

ENERGY UTILITY

MUST BE COMPLETED BY UTILITY (Attach additional pages as needed)

Company name/CPUC Utility No.:

Utility type:
- ☐ ELC ☐ GAS ☐ WATER
- ☐ PLC ☐ HEAT

Contact Person:
Phone #:
E-mail:
E-mail Disposition Notice to:

EXPLANATION OF UTILITY TYPE

ELC = Electric GAS = Gas WATER = Water
PLC = Pipeline HEAT = Heat

(Date Submitted / Received Stamp by CPUC)

Advice Letter (AL) #: Tier Designation:

Subject of AL:

Keywords (choose from CPUC listing):

AL Type: ☐ Monthly ☐ Quarterly ☐ Annual ☐ One-Time ☐ Other:

If AL submitted in compliance with a Commission order, indicate relevant Decision/Resolution #:

Does AL replace a withdrawn or rejected AL? If so, identify the prior AL:

Summarize differences between the AL and the prior withdrawn or rejected AL:

Confidential treatment requested? ☐ Yes ☐ No

If yes, specification of confidential information:
Confidential information will be made available to appropriate parties who execute a nondisclosure agreement. Name and contact information to request nondisclosure agreement/ access to confidential information:

Resolution required? ☐ Yes ☐ No

Requested effective date: No. of tariff sheets:

Estimated system annual revenue effect (%):

Estimated system average rate effect (%):

When rates are affected by AL, include attachment in AL showing average rate effects on customer classes (residential, small commercial, large C/I, agricultural, lighting).

Tariff schedules affected:

Service affected and changes proposed[1]:

Pending advice letters that revise the same tariff sheets:

[1]Discuss in AL if more space is needed.

Protests and all other correspondence regarding this AL are due no later than 20 days after the date of this submittal, unless otherwise authorized by the Commission, and shall be sent to:

CPUC, Energy Division
Attention: Tariff Unit
505 Van Ness Avenue
San Francisco, CA 94102
Email: EDTariffUnit@cpuc.ca.gov

Name:
Title:
Utility Name:
Address:
City:
State: Zip:
Telephone (xxx) xxx-xxxx:
Facsimile (xxx) xxx-xxxx:
Email:

Name:
Title:
Utility Name:
Address:
City:
State: Zip:
Telephone (xxx) xxx-xxxx:
Facsimile (xxx) xxx-xxxx:
Email:

ATTACHMENT A

Advice No. 6018

PLR 122708-21

ATTACHMENT A

Internal Revenue Service

Index Number: 168.00-00

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-122708-21

Date:
May 01, 2022

LEGEND:

Parent =

Taxpayer =

State A =

Commission 1 =

Commission 2 =

Year A =

Period A =

Dear

This letter responds to a request for a private letter ruling dated October 8, 2021, and submitted on behalf of Taxpayer regarding § 168(i)(9) of the Internal Revenue Code (Code), prior § 167(l) of the Code, and § 1.167(l)-1 of the Income Tax Regulations, and Section 13001(d) of Pub. L. 115-97 (131 Stat 2054) (“ the TCJA”) (together, the “Normalization Rules”), as applied to the calculation of the method used by Commission 2 in a recent rate proceeding to reflect federal income tax expense reductions for Taxpayer for excess deferred federal income taxes created by the corporate tax rate reduction included in the TCJA.

FACTS:

Parent is a State A corporation. Parent is the common parent of a consolidated group that includes Taxpayer (a subsidiary of Parent). Taxpayer is also a State A corporation. Taxpayer's common stock is wholly owned by Parent through a different subsidiary. The consolidated group, including Parent and Taxpayer, files its return on a calendar year basis. Taxpayer is engaged is the business of supplying and delivering natural gas to customers.

For rate setting purposes, Taxpayer is under the jurisdiction of Commission 1 and Commission 2. Both regulators set the rates that Taxpayer charges its customers on a cost-of-service rate of return basis – in which the regulators allow the Taxpayer to charge an amount that will cover its costs of providing the energy and yield the Taxpayer a predetermined rate of return on invested capital.

Both Commission 1 and Commission 2 treat accumulated deferred federal income tax liabilities ("ADFIT") and excess deferred federal income tax liabilities ("EDFIT") as a reduction to rate base in setting the allowed return for the utilities that they regulate. Taxpayer has claimed accelerated depreciation on its public utility property to the full extent those deductions have been available. Taxpayer has normalized its federal income taxes deferred as a result of it claiming these deductions in accordance with the Normalization Rules.

Commission 1 has established the Uniform Systems of Accounts ("USOAs"), prescribing the accounting rules which are used by most electric and gas utilities under its jurisdiction. Taxpayer employs the USOAs. The USOAs contain several definitions relevant to Taxpayer's request. Specifically, the USOAs define:

cost of removal ("COR") as the cost of demolishing, dismantling, tearing down or otherwise removing [electric/gas] plant, including the cost of transportation and handling incidental thereto.

"salvage value" as the amount received for property retired, less any expenses incurred in connection with the sale or in preparing the property for sale.

"net salvage value" as the salvage of property retired less the cost of removal.

"service value" as the difference between original cost and net salvage value of [electric/gas] plant.

"service life" as the time between the date [electric/gas] plant is includible in [electric/gas] plant in service, or [electric/gas] plant leased to others, and the date of its retirement.

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

Therefore, for the purposes of regulatory reporting, the net positive value or net cost of disposing an asset at the end of its life is incorporated into the annual depreciation charge. Salvage Value and COR are, therefore, components of establishing the applicable depreciation rate. The combined rate, including depreciation, salvage, and COR, is considered the Composite Rate that is approved by Commission 2.

Although the Composite Rate is approved by Commission 2 and includes each of these items, COR and salvage rates are tracked separately from accumulated depreciation in Taxpayer's property-related deferred tax records. Taxpayer distinguishes between COR book/tax differences and depreciation method/life differences in their records even though both are included in Taxpayer's depreciation book rates and expense. Taxpayer's property-related software system tracks the reversals of these differences separately.

In order to fund its future COR, Taxpayer estimates its future COR and then spreads the estimated cost ratably over the life of the asset through adding the COR to the annual depreciation charge used by Commission 2 to calculate the allowable rate for Taxpayer to charge its customers. If the COR is greater than the salvage value of the public utility property, then the Taxpayer's property will have a negative net salvage value – which will increase the depreciation rate (i.e. total accumulated depreciation will be greater than the value of asset). Alternately, if the net salvage value is positive it too will be reflected in Taxpayer's depreciation rate. Depreciation expense based on the deprecation rate will then be utilized by Commission 2 in computing the allowable rates for Taxpayer to charge its customers. In most cases the COR is more than the salvage value and thus net salvage value is negative, increasing the Taxpayer's accumulated depreciation account. When the COR is actually incurred, the amount expended is charged to that same accumulated depreciation account, reducing the balance.

For tax purposes, COR is deductible only when actually incurred. Taxpayer, therefore, reports its customer collections that fund the COR reserve as taxable income over the operating life of an asset, claiming an offsetting tax deduction only at the end of the life of that asset when the asset is removed. Since COR is normalized in setting rates, customers are provided a tax benefit as they fund the COR reserve – prior to the time Taxpayer actually claims that benefit on its consolidated tax return.

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

In anticipation of complying with the TCJA excess deferred tax Normalization Rules and the subsequent return of the TCJA Section 13001(d) excess tax reserve ("ETR") to customers, Taxpayer used its historical plant-related records in its regulatory books of account to separately compute both (1) its DTA related to COR and (2) its deferred tax liability (DTL) related to method/life differences and the associated EDFIT to be returned to customers, which included gross salvage value.

Taxpayer's Recent Commission 2 Proceeding:

In Year A Taxpayer filed an application with Commission 2 to set its rates for Period A. Upon the enactment of the TCJA, Taxpayer updated its filing with Commission 2 to reflect the impact of the lowered corporate tax rate. Among the impacts considered by Commission 2 was the proper computation of the Average Rate Assumption Method (ARAM) used to determine the timing of the return of the EDFIT to ratepayers. Specifically, when computing ARAM (as per TCJA Section 13001(d)(3)(B)), whether the COR should be included or not. Ultimately, Commission 2 and Taxpayer did not reach an agreement on the inclusion of COR into the ARAM and the resulting disagreements relating to the COR-related EDFIT.

In summary, Commission 2's proposed method of computing the return of EDFIT to customers under ARAM included the accrual for COR, resulting in a larger amount of book depreciation in all years (and an earlier return of EDFITR to customers) than under the computational method proposed by Taxpayer. (Taxpayer's proposed method did not include COR in the ARAM calculation.) Commission 2 adopted its method of computing the return of EDFIT in its Period A decision. Despite the disagreement, Commission 2 emphasized that it intended for Taxpayer to comply with the Normalization Rules at all times and found it prudent and reasonable to allow Taxpayer to seek recovery in the event the Internal Revenue Service issued a ruling or other guidance clarifying that COR should be excluded from ARAM calculations in these circumstances. Commission 2 recommended that Taxpayer seek a private letter ruling.

RULINGS REQUESTED:

1) Whether, under the circumstances described above, Commission 2's method of including book COR in the calculation of ARAM for the return of the EDFIT to ratepayers is inconsistent with the Normalization Rules?

2) Whether, under the circumstances described above, the method proposed by Taxpayer excluding book COR from the ARAM calculation for return of the EDFIT to the ratepayers is consistent with the Normalization Rules?

3) Whether, under the circumstances described above, if the Service rules that the method proposed by Commission 2 is inconsistent with the Normalization Rules, Taxpayer's use of the method proposed by Commission 2 as provided in Commission 2's Period A decision, will not be a violation of the Normalization Rules, provided Commission 2 (i) approves the method proposed by Taxpayer (or otherwise required by the Service) and (ii) allows Taxpayer to recover any difference in the rates charged to customers under Commission 2's proposed method and Taxpayer's method, as provided in Commission 2's Period A decision?

LAW AND ANALYSIS:

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

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

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

differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

Section 13001(a) of the TCJA reduced the corporate tax rate from 35 percent to 21 percent for taxable years beginning after December 31, 2017. TCJA Section 13001(d)(1) provides that a normalization method of accounting shall not be treated as being used with respect to any public utility property for purposes of § 167 or § 168 if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the ETR[1] more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method (ARAM).

TCJA Section 13001(d)(3)(A) provides that "excess tax reserve" means the excess of reserve for deferred taxes (as described in § 168(i)(9)(A)(ii) as of the day before the corporate rate reductions provided in the amendments made by TCJA Section 13001(a) take effect, over the amount which would be the balance in such reserve, if the amount of such reserve were determined by assuming that the corporate tax rate reductions provided in the TCJA were in effect for all prior periods.

TCJA Section 13001(d)(3)(B) defines ARAM as the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes. Under such a method, during the time period in which the timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying – the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by the amount of the timing differences which reverse during such period.

Rev. Proc. 2020-39, Section 4.01 provides that under Section 13001(d)(1) of the TCJA, taxpayers must use ARAM to calculate the reversal of their ETR, if the taxpayer's regulatory books are based upon the vintage account data necessary to use ARAM. However, if the taxpayer's regulatory books are not based upon the vintage account data that is necessary for the ARAM, use of the ARAM is not required. Rev. Proc. 2020-39, Section 4.02 provides that the determination of whether a taxpayer's regulatory books contain sufficient vintage account data necessary to use the ARAM is determined based on all the facts and circumstances. Rev. Proc. 2020-39, Section 5 states that the TCJA ETR normalization requirements are part of the overall pre-existing deferred tax Normalization Rules and that the revenue procedure is intended to be consistent with those rules.

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[1] ETR is used in section 13001 to refer to that portion of the reserve for deferred taxes described in § 168(i)(9)(A)(II) that is determined by the decrease in the corporate tax rate by the TCJA. It is sometimes referred to herein as EDFIT.

For the COR-related amounts at issue in this request, the amounts are not protected by the Normalization Rules. Generally, § 168(i)(9)(A) does not refer to COR, which is deductible under § 162. Moreover, there is no acceleration of taxes for COR that inures to the benefit of the utility company initially but must be reflected in a reserve and returned pro-rata to ratepayers, but rather, a deferral of the payment of those taxes. While COR may be a component of the calculation of the amount treated as book depreciation, it is a deduction under § 162 and not, like actual accelerated tax depreciation, under § 168. While method and life differences closely related to depreciation are created and reversed solely through depreciation, such is not the case with COR. While the COR timing differences may often originate as a component of book depreciation, it reverses through the incurred COR expenditure.

The ETR created by the TCJA is the excess of the reserve for deferred taxes under § 168(i)(9)(A)(ii), as of the date before the corporate rate reductions under TCJA take effect, over the amount the reserve balance would be if the rate reductions had been in effect for all prior periods. The ETR is reduced over the remaining lives of the property which gave rise to such reserve for deferred taxes based on the reversal of the underlying depreciation method and life differences subject to the Normalization Rules of Code Section 168(i)(9)(A)(ii). Thus, because COR is not subject to normalization, as concluded above, COR related amounts are not used in the computation of the ETR.

Because of their similarity, we address requests 1 and 2 together. As discussed previously, ARAM is the required method for the reduction/reversal of the ETR. Because COR is not included in the ETR, COR should not be included in the ARAM calculations to return the ETR to ratepayers under the Normalization Rules.

The third Issue requires that we consider the question of whether, under these facts, the inclusion of COR in the ARAM calculation as directed by Commission 2 in its Period A decision constitutes a normalization violation.

Section 4.01(6) of Rev. Proc. 2020-39, 2020-36 I.R.B. 546, provided transition rules due to the reality that many utilities had already been required to adjust rates due to the TCJA. According to this provision in Rev. Proc. 2020-39, "[u]tilities may correct any method of reversing ETR that is not in accord with this revenue procedure at the next available opportunity. The methods adopted prior to the publication of this revenue procedure that are not in accord with this revenue procedure are not considered to be a violation of the Normalization Rules if so corrected. This corrective action will require the utility to consult with its regulator and obtain its regulator's consent. Utilities are not in conflict with section 13001(d) of the TCJA if the utilities follow such a path to correct potential normalization violations prospectively. These rules extend to companies that may not have started the amortization of ETRs or may be re-deferring the amortization as they evaluate their records."

Additionally, § 168(f)(2) itself provides that the depreciation deduction determined under § 168 shall not apply to any public utility property (within the meaning of §

168(i)(10)) if the taxpayer does not use a normalization method of accounting. However, in the legislative history to the enactment of the normalization requirements of the Investment Tax Credit (ITC), 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.

Commission 2 has not required or insisted upon treatment by Taxpayer that it knows is noncompliant with the Normalization Rules. Rather, Commission 2 recognized that the matter was not clear at the time and recommended that Taxpayer seek a ruling from the Service. Further, Commission 2 has directed Taxpayer to comply with the Service's interpretation of the applicable tax laws by filing with Commission 2 to seek an appropriate adjustment to its revenue requirement and/or rate base in the event that Taxpayer requests and receives a private letter ruling from the IRS.

Taxpayer's failure to comply with the Normalization Rules was inadvertent. Because Commission 2, as well as Taxpayer, has at all times sought to comply, and because corrective actions will promptly be taken, Taxpayer's use of the method proposed by Commission 2 does not constitute a normalization violation.

CONCLUSIONS:

Based on the foregoing, we conclude as follows:

1) Commission 2's method of including COR in the ARAM for the return of the EDFIT to ratepayers is inconsistent with the Normalization Rules.

2) Taxpayer's method of excluding COR from the ARAM computation for return of the EDFIT to ratepayers is consistent with the Normalization Rules.

3) As stated in Conclusion 1, the method proposed by Commission 2 is inconsistent with the Normalization Rules. However, Taxpayer's use of the method proposed by Commission 2 as reflected in Commission 2's Period A decision, is not a violation of the Normalization Rules, provided Commission 2 (i) approves the method proposed by Taxpayer (or otherwise required by the Service) and (ii) allows Taxpayer to recover any difference in the rates charged to customers under Commission 2's proposed method and the Taxpayer's method.

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

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

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

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

Sincerely,

Patrick S. Kirwan

Digitally signed by Patrick S. Kirwan
Date: 2022.05.01 09:32:09 -04'00'

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