**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

In the Matter of the Application of Kansas Gas Service, a Division of ONE Gas, Inc. for Adjustment of its Natural Gas Rates in the State of Kansas.	))))	Docket No. 24-KGSG-_610_ -RTS

DIRECT TESTIMONY

OF

KENNETH W. EAKENS

ON BEHALF OF KANSAS GAS SERVICE

A DIVISION OF ONE GAS, INC.

MARCH 1, 2024

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DOCKET NO. 24-KGSG-___-RTS

I. <u>Position and Qualifications</u>

Q. Please state your name and business address.

A. My name is Kenneth W. Eakens, and my business address is 15 E. 5th Street Tulsa, Oklahoma 74103.

Q. By whom are you employed and in what capacity?

A. I am the Director, Tax Compliance and Reporting for ONE Gas, Inc. ("ONE Gas"). I have responsibility for the Tax and Plant Accounting functions for ONE Gas. These responsibilities include the accounting, compliance and financial reporting as it relates to those functions for ONE Gas and its divisions, including Kansas Gas Service ("KGS" or the "Company").

Q. Please describe your education and professional experience.

A. I earned a Bachelor of Science degree in Business Administration from Southeast Missouri State University with an accounting major and a finance minor. For more than 30 years, I have worked in tax accounting and compliance roles. Prior to my current position, I was Manager, Tax Accounting and Reporting, for FedEx Corporation & Subsidiaries ("FEDEX") where I was responsible for the accounting, Securities and Exchange Commission reporting and Sarbanes Oxley tax processes. During my tenure at FEDEX, I also served as Manager, Tax Compliance & Audit. Prior to joining

FEDEX, I was a Tax Specialist at Ameren Services in St Louis, Missouri. In that role, I was the lead specialist for the tax accounting, compliance, and regulatory reporting for several of the large utility subsidiaries in the Ameren group. Prior to joining Ameren, I was a Tax Auditor for the State of Missouri. In that role, I specialized in audits of Fortune 500 companies for sales, use, income and franchise taxes. I am licensed as a Certified Public Accountant in Missouri.

Q. Was this testimony prepared by you or under your direct supervision?

A. Yes, it was.

Q. Have you previously testified before this Commission?

A. No.

II. <u>Executive Summary</u>

Q. Please summarize the key issue(s) you address.

A. The key issues to address in my testimony are:

1. Accumulated Deferred Income Taxes ("ADIT")
    - i. Explanation of ADIT
    - ii. ADIT for ratemaking purposes and KGS's proposed adjustments
2. Excess Deferred Income Tax ("EDIT")
    - i. Explanation of EDIT
    - ii. Discuss how KGS has treated EDIT based on the approved Settlement in KGS's prior rate case
    - iii. EDIT proposed treatment
    - iv. Cost of Removal ("COR") treatment based on the Private Letter Rulings ("PLR") from the Internal Revenue Service ("IRS")
    - v. Tracker Mechanism treatment based on the PLR from the IRS
    - vi. EDIT from Kansas state income tax rate change

vii. Other EDIT issues

3. Sponsor portions of Section 11 of the Minimum Filing Requirements ("MFR") on Income Taxes

III. ADIT

i. Explanation of ADIT

Q. Mr. Eakens, you sponsor several adjustments to ADIT. Please begin your discussion of these adjustments by defining ADIT.

A. ADIT reflects the cumulative timing differences between Income Tax Expense recorded pursuant to accounting principles generally accepted in the United States ("GAAP") for financial reporting purposes and actual income taxes paid to taxing authorities. While there are several contributing factors impacting the ADIT balance, typically the ADIT is a net liability rather than an asset. Significant activity in this account is driven by accelerated tax depreciation contrasted with more conservative book depreciation. These differences in depreciation rates create a difference between "book income" and "taxable income" which, when applied to the effective tax rate, results in a deferred tax amount that is recorded to the ADIT account, usually creating a liability. The difference between book and tax depreciation rates reverses over time (i.e., tax depreciation is initially higher than book but then this trend reverses itself as the asset becomes fully depreciated for both book and tax purposes) and thus, is an example of what is termed a temporary difference. As an asset becomes fully depreciated for tax purposes, the book depreciation continues and the difference between the two cumulative depreciation balances is reduced until it is eventually eliminated, resulting in the elimination of the ADIT balance for that particular asset. Temporary differences affect the timing of the payment of income taxes contrasted with the recognition of Income Tax Expense pursuant to GAAP. Over time, however, these temporary differences are reversed there by eliminating the ADIT balance as the timing differences are reflected in current tax expense. During the period when the annual tax depreciation is greater than the annual book depreciation of an asset, the taxable income will be lower and thus taxes paid will be lower than the related book income tax expense, creating a deferred tax liability. When the turn-around occurs, the book depreciation will be higher than the tax depreciation, thus producing lower book income, resulting in lower income tax expense compared with taxes paid, which reduces the deferred tax liability.

ii. <u>Accumulated Deferred Income Taxes for ratemaking purposes & proposed adjustments</u>

Q. How is the ADIT account treated for ratemaking purposes?

A. The typical regulatory treatment of the net ADIT balance is to reflect it as an offset to rate base. This treatment is appropriate because the net ADIT liability represents a source of financing to the utility. The application of the net ADIT balance as a rate base offset is generally not a source of contention in rate proceedings. As shown in Section 6 at Schedule 6-E of the Application, KGS has recorded a net ADIT liability of $ $234.3 million as of September 30, 2023. The pro forma balance of $219.5 million is treated as an offset to rate base, consistent with traditional regulatory treatment. The following table reconciles the net ADIT liability recorded at September 30, 2023, with the adjustments that have been proposed.

Net ADIT Asset (Liability) ($ in millions)	**ADIT**	**ADIT - NOL**	**ADIT Net**
Balance per book at September 30, 2023	**$ (267.3)**	**$33.0**	**$(234.3)**
Adjustments:			
WC 5 – Eliminate Pension/ OPEB funding ADIT	20.0		20.0

WC 6 – Eliminate NOL related to Pension/OPEB funding ADIT		(6.3)	(6.3)
WC 7 – Eliminate COGR ADIT	1.1		1.1
WC 8 – Impact of Winter Storm URI	67.1		67.1
WC 9 – Net Operating Loss associated with Winter Storm URI	(67.1)		(67.1)
Pro Forma balance at September 30, 2023	**$ (246.2)**	**$26.7**	**$(219.5)**

In addition to the KGS net ADIT liability, Adjustment WC-10, totaling $3.2 million, reduces the Company's rate base for an additional ADIT liability attributable to Corporate deferred tax balances allocated to KGS.

Q. What is adjustment WC 5 and why is it necessary?

A. Adjustment WC 5 reduces the ADIT Liability (thus increasing rate base) $20.0 million. This adjustment is necessary to eliminate the impact of pension and other post-employment benefits ("OPEB") funding on KGS ADIT balance as agreed to as part of the Stipulation and Agreement in Docket No. 10-KGSG-130-ACT ("10-130 Docket").

Q. Please provide an overview of the 10-130 Docket.

A. The 10-130 Docket dealt with complex accounting/funding issues related to utility pension and OPEB costs. The Order in the 10-130 Docket consisted of two major elements. First, it permitted KGS to defer, as a regulatory asset or liability, differences between current year GAAP pension and OPEB expense and those corresponding expense levels included in each utility's revenue requirement determined in its most recent rate case. Second, the Order required KGS to make contributions to an external trust fund.

Q. What is the implication of this over-funding on the ADIT balance?

A. The cumulative pension and OPEB funding in excess of the cumulative book expense has resulted in an ADIT balance timing difference because the funding of pension and OPEB costs is deductible for tax purposes when the contributions are made rather than the lower book expense within the calculation of the deferred tax expense for GAAP purposes. This difference between the funding level and the book expense creates a deferred tax liability at September 30, 2023, of approximately $ 20.0 million, calculated using the corporate federal tax rate of 21%.

Q. Does the excess funding result in an asset that is included in rate base?

A. No. The Order in the 10-130 Docket provided that there would be no rate base recognition for any excess contributions beyond the pension/OPEB funding requirements. Accordingly, KGS has not included a rate base additive for its level of funding in this application. The pertinent language from the KCC's order in the 130 Docket is:

> KGS's application with respect to Tracker 2, to establish a regulatory asset/liability account to accumulate the difference between the current year pension/OPEB contribution to its established trusts and current year GAAP pension/OPEB costs, not as a component of rate base as set forth by Staff's recommendation is hereby approved.

Q. How does the language quoted from the 10-130 Docket support your adjustment to eliminate the ADIT liability associated with the excess pension/OPEB funding?

A. Absent this adjustment, KGS would be penalized for its excess funding through a reduction in rate base. The excess funding has benefited customers and KGS should not be faced with a reduction to its rate base, through its ADIT account, as a direct result of its level of funding. The language in the Order indicates there should be no rate base recognition of the excess funding as an additive to rate base. Likewise, it is consistent with the intent of the Order, to also not recognize the impact of the deferred tax liability generated as a result of the funding in the rate base.

Q. What is adjustment WC 6 and why is it necessary?

A. Adjustment WC 6 reflects an adjustment to ADIT for the Company's net operating loss ("NOL") associated with pension/OPEB using the federal corporate tax rate of 21%. Adjustment WC 6 reduces rate base approximately $6.3 million by reducing the NOL balance within the deferred tax liability associated with excess pension and OPEB funding as discussed in Adjustment WC 5. The justification for Adjustment WC 6 is identical to that of Adjustment WC 5. Similar adjustments were proposed and accepted in the last KGS base rate case.

Q. What is adjustment WC 7 and why is it necessary?

A. Adjustment WC 7 decreases the ADIT liability approximately $1.1 million, calculated using the federal corporate tax rate of 21%, and is necessary to remove the impacts associated with KGS's Cost of Gas Rider from our ADIT liability. At any point in time, customers have either under- or over-funded the cost of gas and /or the transportation and storage costs KGS incurs to deliver natural gas to consumers. KGS monitors the status of the over/under account and reports monthly to the KCC Staff. This difference is either taxable or tax deductible depending upon the balance. Since there is an equal likelihood of a positive or negative balance in this account going forward, I recommend that the impact of the balance at the end of the test period be removed for purposes of establishing the appropriate ADIT liability balance used as a rate base deduction. There is no income statement impact from this issue, thus an adjustment to pro forma revenues or expenses is unnecessary.

Q. What are adjustments WC 8 and WC 9 and why are they necessary?

A. Adjustment WC 8 decreases the ADIT liability approximately $67.1 million, and Adjustment WC 9 decreases our NOL carryforwards, thereby increasing the net ADIT Liability by a corresponding $67.1 million. These adjustments are necessary to remove the impacts associated with Winter Storm Uri from KGS's net ADIT liability. In 2022, KGS (through a Special Purpose Entity) issued securitized debt related to the recovery of qualified extraordinary costs associated with Winter Storm Uri (Docket No. 22-KGSG-466-TAR). The debt was securitized by an intangible right to receive payments from KGS customers over a period of 10 years. The ADIT related to Winter Storm Uri was addressed in the financing order and was incorporated into the qualified extraordinary costs inclusive in the amount to be recovered from the customers. At the time of Winter Storm Uri, KGS incurred significant tax losses resulting in NOL carryforwards, which would offset the future recovery of the gas costs incurred for tax purposes. For purposes of determining rate base, we have assumed the NOL derived from the qualified extraordinary costs offsets the deferred tax liability by the same amounts. Because the recovery of the qualified extraordinary costs has been addressed through the issuance of the securitized bonds and no unrecovered deferred costs have been included in rate base, the associated deferred tax effects to both our ADIT liability and our NOL Carryforwards have also been removed from rate base through Adjustments WC 8 and WC 9. There is no income statement impact from this issue, thus an adjustment to pro forma revenues or expenses is unnecessary.

IV. EDIT

i. Explanation of EDIT

Q. Please explain EDIT.

A. Excess deferred taxes results from the remeasurement of ADIT to reflect the new tax rate at which it expects the related timing differences to reverse after a change in the income tax rate. The difference between the ADIT balance on the day before the tax change became effective and the ADIT balance if it were determined by assuming the new, lower corporate rate was in effect for all prior periods, is the EDIT. For regulated public utility property, Accounting Standards Codification ("ASC") 980-740-25 requires that a regulatory asset or liability be recorded for the resulting re-measurement of ADIT if it is probable that the excess will be collected from customers or returned to customers through future rates. The regulatory liability is grossed-up for the income tax effect of the increase or decrease in revenues. The regulatory asset or liability is also itself a temporary tax timing difference for which a deferred tax asset or liability will be recognized.

Q. What is the amount of EDIT for KGS?

A. The Company has EDIT balances related to the enactment of Tax Cuts and Jobs Act ("TCJA") in 2017. Those balances are comprised of protected and unprotected EDIT. The TCJA EDIT balances related to protected and unprotected EDIT are net of amortization that has occurred since the prior rate case. Also, the Company has an EDIT balance related to Kansas exempting utilities from Kansas state corporate income taxes (K.S.A. 66-1,239(f); K.S.A. 79-32,113(d)(2)). The entire EDIT balance associated with the state income tax rate change is unprotected. No amortization has occurred for EDIT related to the State corporate income taxes.

The following table reconciles the net EDIT liability recorded at September 30, 2023, with the adjustments that have been proposed. The table is contained on the next page. The remainder of this page has been left blank intentionally.

Net Regulatory Liability (\$ in millions)	**Regulatory Liability**	**Regulatory Liability-NOL**	**Net Regulatory Liability**
Balance per book at September 30, 2023	**\$ (179.2)**	**\$29.1**	**\$(150.1)**
Adjustments:			
WC 11 – Removal for Pension/OPEB/PGA/NOL	(1.0)	0.1	(0.9)
WC 12 – Removal for Pension/OPEB/PGA/NOL for State Rate Change	10.0		10.0
Pro Forma balance at September 30, 2023	**\$ (170.2)**	**\$29.2**	**\$** (141.0)

In addition to the KGS net regulatory liability, Adjustment WC-13, totaling \$4.4 million, reduces the Company's rate base for an additional regulatory liability attributable to the re-measurement of ONE Gas Corporate deferred tax balances allocated to KGS..

Q. What are adjustments WC 11 and WC 12 and why are they necessary?

A. Adjustments WC 11 and WC 12 are the adjustments to EDIT that correspond to Adjustments WC 5, WC 6 and WC 7 to the Company's ADIT balance. These adjustments remove the impact of the remeasurement of ADIT for items noted in Adjustments WC 5, WC 6 and WC 7 from the EDIT regulatory liability, Adjustment WC 11 represents the adjustment related to EDIT from the Tax Cuts and Jobs Act of 2017 income tax rate change, and Adjustment WC 12 represents the adjustment related to the Kansas state income tax rate change in 2020.

Q. Does the EDIT regulatory liability include any associated tax gross up?

A. Yes, the EDIT liability has an associated tax gross up, which results in an offsetting ADIT asset. ASC 980-740-25 required the regulatory liability to be grossed-up for the income tax effect of the increase or decrease in future revenues as the EDIT liability is amortized into our cost of service for determining base rates. The gross-up regulatory asset or liability associated with EDIT itself is considered a temporary tax timing difference for which a deferred tax asset or liability is recognized. Because the gross-up regulatory liability would generate an offsetting deferred tax asset, the tax gross-up associated with the EDIT regulatory liability has no effect on rate base. At September 30, 2023, The Company has a net $38.3 million liability recorded as an EDIT gross-up liability with a corresponding deferred tax asset in the same amount. Accordingly, rate base reflects only the remeasured deferred taxes using the current enacted federal and state tax rates and the related regulatory liability resulting from the re-measurements.

Q. Please describe protected and unprotected excess ADIT.

A. With the implementation of tax reform in 1986, the term "protected excess ADIT" was adopted to refer to excess ADIT balances that were described in Section 203(e) of the Tax Reform Act of 1986 ("TRA 1986"). The TRA 1986 allowed the reduction to the excess tax reserve under Section 203(e) to occur no more rapidly than the rate under the average rate assumption method ("ARAM"). "Unprotected excess ADIT" referred to all other balances. A similar provision is included in the TCJA at Section 13001(d). To maintain a normalization method of accounting, this provision requires that the utility reduce its protected excess tax reserve no faster than it would be reduced under ARAM. The provision also allows for use of another alternative method if the utility does not have the data needed for ARAM. The Company has the data needed for ARAM, so the alternative method is not applicable.

Q. What items on KGS and ONE Gas books are protected under the normalization rules?

A. The EDIT attributable to federal method/life depreciation differences are protected. There are other items protected in addition to federal method/life depreciation differences such as net operating losses attributable to accelerated plant book to tax differences resulting in large tax deductions which generated losses. In the Company's books and records, all other excess ADIT amounts, including all amounts resulting from a change in state income tax rates, are unprotected under the normalization rules.

Q. What would happen if a utility violated normalization rules?

A. The penalties associated with a normalization violation can be very punitive. The Company could lose the ability to take accelerated depreciation. Furthermore, the TCJA calls for an additional penalty that is assessed for the amount by which the excess tax reserve was reduced more rapidly than was allowed using a normalized method of accounting. These penalties would be severely detrimental to both the Company and the Company's customers and would significantly increase the cost of service.

ii. <u>How KGS treated EDIT in its Prior Rate Case</u>

Q. Could you please discuss how KGS treated EDIT in its prior rate case?

A. In accordance with the Order Approving Partial Unanimous Settlement Agreement in Docket No. 18-KGSG-560-RTS ("18-560 Docket"), protected excess ADIT was amortized using ARAM methodology. KGS was required to track any differences in the protected EDIT amortization reflected in rates compared to the actual amortization. Unprotected EDIT was amortized over five years. The revenue requirement included the amortization and the associated gross up as a reduction to revenue. The reduction was part of the base rates which went into effect February 2019. The unprotected portion of the EDIT liability was fully amortized by February 2024.

iii. <u>EDIT Proposed Treatment</u>

Q. How does KGS propose to treat the amortization of EDIT in this case?

A. The Company proposes to include the amortization of EDIT as a component of its cost of service that will be grossed up for taxes as part of the revenue requirement. This will be consistent with how EDIT amortization was treated in the last case. For the protected portions of EDIT, the Company proposes to continue to amortize those balances using ARAM as required by the normalization provisions of the United States Internal Revenue Code, as amended ("IRC"). The following sections discuss the impacts of recent IRS guidance, a timing issue related to the amortization of unprotected EDIT from the previous case, EDIT from the change in the Kansas state income tax rate, and certain miscellaneous EDIT issues.

Q. Has there been any guidance or interpretations by the IRS or other authorities that would impact the EDIT recorded at the last rate case filing?

A. Yes, based on IRS guidance the Company will need to address the existing methodology around the treatment of Cost of Removal and the use of Tracker's for protected EDIT.

iv. <u>Cost of Removal ("COR") Treatment based on a PLR from the IRS</u>

Q. Please describe the IRS PLR included as exhibit KWE-1.

A. The Company has been made aware of a potential IRS normalization issue through the issuance of a PLR to another utility, attached to my testimony as Exhibit KWE-1. The normalization issue is related to KGS's current treatment of the COR portion of its depreciation expense, which creates a deferred tax asset and, pursuant to the new PLR, is not "protected" under IRS normalization rules in the ARAM amortization calculation.

Q. Please explain this issue related to COR.

A. Per the PLR, the COR portion of depreciation is not "protected" under IRS normalization rules. KGS previously treated the COR portion of depreciation as "protected" and, as such, did not separate COR from depreciation in its regulatory depreciation calculations. Importantly, KGS's prior treatment of COR benefited ratepayers because the COR portion was actually an asset and would have reduced the amount of unprotected EDIT returned to ratepayers through the Rider. Additionally, at the time of the TCJA, KGS did not estimate a COR component of its accumulated depreciation for purposes of determining the "protected" balance of book versus tax depreciation timing differences. Rather, the timing difference that creates a deferred tax and associated EDIT asset related to COR was netted against the protected portion of its EDIT and amortized using the ARAM calculation consistent with protected timing differences of book versus tax depreciation. This was consistent with how KGS treated all protected EDIT. Now, to avoid a normalization violation under the new PLR, the COR portion of book versus tax depreciation timing differences needs to be separated from both the original EDIT liability and from the depreciation expense used in the ARAM calculation and included as an "unprotected" EDIT asset and amortized as such. Otherwise, the remaining protected EDIT may be returned too quickly under the ARAM calculation.

Q. What is KGS's proposal to address the IRS normalization issue related to COR?

A. KGS has estimated the amount of COR that was included as protected since December 31, 2017, at the time of the TCJA, that should now be considered unprotected. KGS proposes that this amount be accounted for as a separate component of our net EDIT liability and that it be amortized utilizing the same amortization period as the protected plant consistent with depreciation-related timing differences that remain in the protected portion of EDIT (subject to ARAM).

Q. Why is it important to separately account for the COR portion of unprotected EDIT and utilize a different amortization?

A. COR in depreciation rates is deducted for tax purposes when the expenses are incurred with the disposal of an asset. As a result, the book depreciation expense being incurred prior to the tax deduction results in a deferred tax asset. When tax rates changed in the TCJA, this deferred tax asset is remeasured based on the new tax rate and the adjustment creates an EDIT asset, meaning it is an amount that will be "collected" from customers. Unprotected EDIT can be credited to ratepayers over any period authorized by the regulatory authority. If the COR had been included with the 5-year amortization of unprotected EDIT, the EDIT credit to customers would have been significantly reduced in the short term. By continuing to utilize the ARAM period for COR, KGS will be able to continue to provide EDIT credits consistent with prior years.

Q. Does this change in treatment affect the total amount of EDIT related to COR to be credited to KGS customers?

A. No.

Q. How does KGS plan to address this potential normalization issue?

A. In Revenue Procedure 2020-39, the IRS has provided a safe harbor for inadvertent normalization violations by indicating that corrective actions which convert a non-compliant crediting method to a compliant crediting method that are taken at the earliest available opportunity will not be considered a normalization violation. KGS believes the earliest available opportunity to take corrective action as provided for in Revenue Procedure 2020-39 is this rate case filing.

Q. Again, will customers receive any more or less EDIT related to COR?

A. No, KGS customers will receive credit for the same amount of EDIT amortization that will reduce the tax expense component of our cost of service.

Q. Are KGS's proposed modifications being made in a way that minimizes the impact of the separation of COR in this rate case filing while ensuring minimal risk of a normalization violation?

A. Yes. In particular, the request to separately account for the COR asset and amortize over the same period as protected plant subject to ARAM as opposed to the 5 years applied to the unprotected EDIT liability determined in the 18-560 Docket will ensure that the amounts of the ongoing credit and its impact on customer rates are consistent with previous credits.

Q. Are there serious consequences if the IRS determines that a normalization violation has occurred if the requested modifications are not approved?

A. Yes. Please refer to the last question in section IV i of this testimony for a discussion of what would happen if it was determined that KGS had a normalization violation.

v. <u>Tracker Mechanism treatment based on the PLR from the IRS</u>

Q. Please describe the IRS PLR contained in exhibit KWE-2.

A. The Company has been made aware of a potential IRS normalization issue through the issuance of a PLR to another utility, attached to my testimony as Exhibit KWE-2. The normalization issue is related to the tracker for protected excess EDIT.

Q. Please explain this issue related to the tracker.

A. The IRS, in PLR 202142002, validated that the consistency rules are an important and operative component of the pre-existing deferred tax normalization rules referenced in Rev. Proc. 2020-39. In the letter ruling, the IRS stated that the Normalization Rules of section 168(i)(9), former section 167(l), and section 13001(d) of the TCJA do not permit taxpayer to:

> Adjust its EDIT ARAM amortization annually without making similar adjustments to rate base, ADIT, book depreciation, and tax expense.

* * *

> Provide a true-up to EDIT ARAM amortization in the year following the rate year based on volume variances between the test year and the rate year without making similar adjustments to rate base, ADIT, book depreciation, and tax expense.

Any adjustments based on the results of a tracker without similar adjustments to the other components of rate base for ratemaking purposes would result in a normalization violation.

Q. What is KGS's request to address the IRS normalization issue related to the tracker?

A. The approved Partial Unanimous Settlement Agreement in the 18-560 Docket required KGS to track the protected portion of EDIT reflected in rates compared to the actual amortization. Due to the normalization issues this may create, KGS has excluded the tracker balance and any related amortization for determining the revenue requirement in this filing and proposes removal of the tracker to avoid any IRS normalization violations in the future.

Q. Are there serious consequences if the IRS determines that a normalization violation has occurred if the requested modifications are not approved?

A. Yes. Please refer to the last question in section IV.i of this testimony for a discussion of what would happen if it was determined that KGS had a normalization violation.

vi. <u>EDIT from Kansas state income tax rate change</u>

Q. Were there any changes in tax rates subsequent to the last rate case?

A. Yes, in May 2020, a bill amending the Kansas state income tax code was signed into law exempting public utilities regulated by the KCC from paying Kansas state income taxes beginning January 1, 2021, and authorized the KCC to adjust utility rates for the elimination of Kansas state income tax beginning January 1, 2021 (K.S.A. 79-32,113(d)(2). As a result of the enactment of this legislation, we remeasured our ADIT.

As a regulated entity, the reduction in ADIT was recorded as an EDIT regulatory liability totaling $66.8 million as shown in Section 6 at Schedule 6-E of the Application.

Q. **Does the EDIT regulatory liability include any associated tax gross up?**

A. Yes, as discussed in Section IV.i of this testimony the EDIT liability has an associated tax gross up, which results in an offsetting ADIT asset. Because the gross-up regulatory liability generates an offsetting deferred tax asset, the tax gross-up associated with the EDIT regulatory liability has no effect on rate base. Accordingly, rate base reflects only the remeasured deferred taxes using the current enacted state tax rate and the related regulatory liability resulting from the re-measurement.

Q. How does KGS plan to address the EDIT from the 2020 Kansas law changes exempting utilities from Kansas state income taxes for periods after 2021?

A. KGS is requesting to amortize the State EDIT over 30 years consistent with K.S.A. 66-1,239(f) . Table KWE-1 shows the calculation of the estimated amortization amount using a 30-year period.

vii. <u>Other EDIT Issues</u>

Q. Subsequent to the last rate case, did the Company have adjustments to EDIT outside of the issues related to the PLRs discussed in this testimony?

A. Yes, at the time of the 2018 rate case, The ADIT and EDIT liabilities were based on estimates. Upon filing ONE Gas's 2017 tax return in 2018, the Company had to update its ADIT and EDIT liabilities from estimates to actual amounts utilized in the tax return filing during the fourth quarter of 2018. This is commonly known as a return to accrual ('RTA") true-up. This true-up was not incorporated into the 2018 rate case. The impact to the EDIT liability was an increase to the protected portion of the EDIT liability totaling approximately $19.2 million and a decrease to the unprotected portion of the EDIT liability totaling approximately $3.4 million.

Q. Are the RTA true-up adjustments reflected in the EDIT liability in this case.

A. Yes, the amounts were recorded in late 2018. The RTA amount associated with the protected portion is subject to the normalization provisions of the IRC and will be part of the ARAM amortization calculation over the life of our fixed assets. The RTA amount associated with the unprotected portion was not part of the unprotected amortization established in the 2018 rate case. Accordingly, the adjustment amount remains deferred in our net EDIT liability to be addressed in this case.

Q. How does the Company propose to treat the RTA amounts?

A. As previously indicated, the protected portion of the RTA true-up is subject to the normalization provisions of the IRC; therefore, it is reflected in the ARAM amortization determined in this case. KGS is requesting to amortize the unprotected EDIT portion of the RTA over 30 years. Exhibit KWE-1 shows the calculation of the estimated amortization amount using a 30-year period.

Q. Is there any other EDIT issue to KGS wishes to address in this filing?

A. Yes, the unprotected EDIT was amortized over five years. The revenue requirement included the amortization and the associated gross up as a reduction to revenue. The reduction was part of the rates which went into effect February 2019. The 5-year period amortization ends in January 2024. The current base rates continue to reflect the amortization of the EDIT liability and related gross up as a reduction to revenues until our base rates are adjusted at the end of this case. In order to prevent the Company from being harmed by its revenues being reduced by more amortization than was originally recorded, KGS requests the deferral of the amortization embedded in current rates for periods after January 2024 until new base rates are determined in this case as a regulatory asset, which will also be addressed as part of this filing. For purposes of estimating this amount we have assumed the amortization would continue from February 2024 through October 2024 commensurate with the approximate timeline expected to administer this case.

Q. How does KGS plan to address the deferral for the potential over amortization of unprotected EDIT?

A. As part of the rate case, KGS ask for the deferral for the over amortization in revenues to be amortized over a period of 30 years. Exhibit KWE-1 shows the calculation of the estimated amortization amount using a 30-year period.

Q. Is a 30-year period reasonable for the amortization of the unprotected RTA true-up and the over amortization of unprotected EDIT?

A. Yes, the 30-year amortization period is consistent with the amortization period allowed by statute for the EDIT associated with the Kansas State income tax rate change. Secondly, using a 30-year amortization period minimizes the impact to customers as the amortization amounts are included in rates over an extended period of time. Additionally, a 30-year amortization period is relatively consistent with the amortization period for protected EDIT as the ARAM amortization occurs over the life of our fixed assets. Lastly, having the amortization of the State EDIT Liability, the RTA true-up and the over amortization deferral on the same amortization schedule as opposed to varying amortization schedules will be administratively easier for the Company to monitor and track in the future.

Q. How does the Company propose to treat protected excess EDIT?

A. Consistent with the prior case, the Company proposes to amortize the protected EDIT using the ARAM methodology in order to remain compliant with the normalization provisions of the IRC utilizing the best information currently available. The unprotected EDIT from the prior case has been fully amortized by February 2024. For the EDIT associated with COR, the Company proposes to amortize the balance using the same amortization percentage as the ARAM Methodology. For the unprotected EDIT for the Kansas state income tax rate change, the RTA true-up and the over amortization of unprotected EDIT from the Company's previous rate case, the Company propose an amortization based on a period of 30 years.

Q. What amount of EDIT will included as amortization in the revenue requirement?

A. Table KWE-1 shows the calculation of the estimated amortization amount using the previously discussed amortization periods. For 2024, the Company estimates approximately $4.4 million will be included as amortization to customers if the Company's proposal is approved, which is included in the revenue requirement as Adjustment IS 40. The calculation in Table KWE-1 utilizes the EDIT balance calculated by the Company and estimated ARAM amortization percentages derived from the Company's fixed asset accounting system that tracks the tax and financial reporting balances and depreciation for the Company and ONE Gas Corporate property plant and equipment.

Kansas Gas Service
Summary of EDIT Adjustments
Table KWE-1

	P	NP (COR)	NP	NP (STATE)	TOTAL	TOTAL ADJUSTMENTS	
Book Amortization for Test Year	$2.05	($0.30)	$6.45		$8.20		
Less: Pension/OPEB/PGA/NOL	$0.32	$0.00	($5.25)		($4.93)	($4.93)	
Regulatory Amortization for Test Year	$2.38	($0.30)	$1.20		$3.27		
Amortization Provision-to-Return			(0.1)		(0.1)	(0.1)	
Amortization State				1.89	1.89	1.89	
Removal of Test Period Non-Protected Regulatory Amortization			(1.20)		(1.20)	(1.20)	
Amortization of the non-protected over-credited (Feb-Oct 2024)			(0.03)		(0.03)	(0.03)	
	$2.38	($0.30)	($0.14)	$1.89	$3.82	($4.38)	- Adj IS-40

V. Taxes

i. Information Regarding Company's Taxes Included in KGS's Application.

Q. Please describe schedules 11-C through 11-H in section 11 of the rate case filing.

A. Schedules 11-C through 11-H include information regarding taxes included in the Company's application and reflects the following:

Schedule 11-C calculates taxable income and income taxes. In determining taxable income, the interest expense was synchronized by multiplying the weighted cost of debt in Section 7 by the rate base shown in Section 3. This schedule provides the necessary components to determine the appropriate taxable income based upon book revenues, expenses and all Pro Forma Adjustments to operations. These values are forwarded to Schedule 11-A;

Schedule 11-D provides a schedule of the taxable income;

Schedule 11-E shows Pro Forma Deferred income tax expense and investment tax credits;

Schedule 11-F describes the test period book/tax timing differences necessary to compute test period income tax expense;

Schedule 11-G shows the calculation of the tax gross-up ratio as well as providing the computation for the interest synchronization calculation; and

Schedule 11-H provides the historical activity of the balance of the deferred investment tax credits and deferred income taxes.

Q. Does this conclude your direct testimony?

A. Yes, it does.

VERIFICATION

STATE OF OKLAHOMA)
) ss.
COUNTY OF TULSA)

Kenneth W. Eakens, being duly sworn upon his oath, deposes and states that he is the Director, Tax Compliance and Reporting for ONE Gas, Inc.; that he has read and is familiar with the foregoing Direct Testimony filed herewith; and that the statements made therein are true to the best of his knowledge, information, and belief.

Kenneth W. Eakens

KENNETH W. EAKENS

Subscribed and sworn to before me this 26 day of February 2024.

KATHLEEN HILL NOTARY # 14000359 EXP. 01/13/26 PUBLIC STATE OF OKLAHOMA

Kathleen Hill

NOTARY PUBLIC

My appointment Expires:

01/13/26

Internal Revenue Service

Number: **202033002**
Release Date: 8/14/2020

Index Number: 168.24-01

In Re:

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-122510-19

Date:
March 26, 2020

LEGEND:

Taxpayer =

Parent =

State A =

Commission A =

Commission B =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Month 1 =

Month 2 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Year 6 =

Dear :

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

FACTS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Taxpayer's Recent Commission A Proceedings

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

The stipulation provides that:

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

RULINGS REQUESTED

Taxpayer requests the following guidance:

1) Under the circumstances described above, is Taxpayer's electric distribution COR-related net DTL "protected" by the Normalization Rules?

2) If Taxpayer's electric distribution COR-related deferred tax is "protected," should that shortfall be treated as a discrete "protected" item or as part of the "protected" method/life difference?

3) Under the circumstances described above, is Taxpayer's gas distribution COR-related net DTA accumulated through the depreciation rate prior to Month 1 of Year 3 "protected" by the Normalization Rules?

4) If Taxpayer's gas distribution COR-related deferred tax accumulated through the depreciation rate prior to Month 1 of Year 3 is "protected," should that shortfall be treated as a discrete "protected" item or as part of the "protected" method/life difference?

5) Under the circumstances described above, is Taxpayer's gas distribution COR-related net DTL accumulated through the fixed estimated cash recovery after Month 1 of Year 3 "protected" by the Normalization Rules?

6) If Taxpayer's gas distribution COR-related net DTL accumulated through the fixed estimated cash recovery after Month 1 of Year 3 is "protected," should that shortfall be treated as a discrete "protected" item or as part of the "protected" method/life difference?

7) If Taxpayer's COR-related deferred tax shortfall is "protected," do the Normalization Rules permit Taxpayer to collect a shortfall any more rapidly than using the ARAM?

8) Do Taxpayer's depreciation-related ADFIT balances created pursuant to the Normalization Rules that are attributable to costs that were capitalized into the basis of depreciable assets prior to Taxpayer changing its method of accounting for those costs remain subject to the Normalization Rules after the change in method of accounting pursuant to which such costs were reclassified as current deductions?

LAW AND ANALYSIS

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

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

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

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

An adjustment under § 481(a) can include amounts attributable to taxable years that are closed by the period of limitation on assessment under § 6501(a). *Suzy's Zoo v. Commissioner*, 114 T.C. 1, 13 (2000), *aff'd*, 273 F.3d 875, 884 (9th Cir. 2001); *Superior Coach of Florida, Inc. v. Commissioner*, 80 T.C. 895, 912 (1983), *Weiss v. Commissioner*, 395 F.2d 500 (10th Cir. 1968), *Spang Industries, Inc. v. United States*, 6 Cl. Ct. 38, 46 (1984), *rev'd on other grounds* 791 F.2d 906 (Fed. Cir. 1986). *See also Mulholland v. United States*, 28 Fed. Cl. 320, 334 (1993) (concluding that a court has the authority to review the taxpayer's threshold selection of a method of accounting *de novo*, and must determine, *ab initio*, whether the taxpayer's reported income is clearly reflected).

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

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

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

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

When there is a change in method of accounting to which § 481(a) is applied, income for the taxable year preceding the year of change must be determined under the method of accounting that was then employed by Taxpayer, and income for the year of change and the following taxable years must be determined under Taxpayer's new method of accounting as if the new method had always been used. *See* § 481(a); § 1.481-1(a)(1); and § 2.05(1) of Rev. Proc. 97-27. In other words: (1) Taxpayer's new method of accounting is implemented beginning in the year of change; (2) Taxpayer's old method of accounting used in the taxable years preceding the year of change is not disturbed; and (3) Taxpayer takes into account a § 481(a) adjustment in computing taxable income to offset any consequent omissions or duplications.

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

Based on the foregoing, we conclude that:

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

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

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

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

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

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

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

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

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

Sincerely,

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

cc:

Internal Revenue Service

Number: **202142002**
Release Date: 10/22/2021

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:B6
PLR-101961-21

Date:
July 26, 2021

Legend

Taxpayer	=
Corporation	=
State A	=
State B	=
Commission A	=
Commission B	=
Order	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=
Year 1	=
Year 2	=
Year 3	=

Dear :

This letter responds to a request for a private letter ruling dated January 7, 2021, submitted by Taxpayer. Taxpayer requests rulings with respect to the application of § 168(i)(9) of the Internal Revenue Code, former § 167(l), and section 13001(d) of the Tax Cuts and Jobs Act, Pub. L. 115-97(the “TCJA”) (together, the Normalization Rules), regarding the proper accounting and ratemaking treatment of excess deferred income taxes (“EDIT”). The relevant facts as represented in Taxpayer’s submission are set forth below.

FACTS

Taxpayer is an electric and natural gas utility headquartered in State A.

Taxpayer is a wholly owned member of Corporation and Subsidiaries consolidated group. Corporation is an energy services holding company incorporated in State B. Taxpayer is included in the consolidated federal income tax return of Corporation. Taxpayer employs a calendar year reporting period and uses an accrual method of accounting. Corporation elected to be treated as a corporation for federal tax purposes. Corporation and Subsidiaries are not presently under audit by the Internal Revenue Service.

Taxpayer is engaged in the production, transmission, and distribution of electricity and the distribution of natural gas in State A. It is subject to the regulatory authority of Commission A and Commission B as to the terms and conditions of service and the rates it is permitted to charge for its service. Its rates are established or approved based on its costs of service, including a return on its capital investment (rate base).

Taxpayer’s rates are established by Commission A on a “cost of service, rate-of-return” basis. Thus, Taxpayer is permitted an opportunity to recover its prudently incurred costs and earn an appropriate return on its rate base, which reflects its net invested capital. The convention employed in State A with respect to rate base is that a utility’s accumulated deferred income tax balance (“ADIT”) offsets gross rate base (rate base computed before reduction by ADIT). Included in Taxpayer’s ADIT balance are a significant amount of deferred taxes attributable to accelerated depreciation claimed with respect to public utility property. Thus, Taxpayer’s ADIT is, to a substantial extent, subject to the normalization rules contained in § 168(i)(9) and former § 167(l). Commission A uses an historical test period consisting of a 12-month period for purposes of determining Taxpayer’s costs and rate base. Results of this test period are adjusted by “pro forma adjustments” to remove materially distortive items and to give effect to known and measurable changes that are not offset by other factors.

As part of this process of setting rates, Taxpayer computes its depreciation expense and its income tax expense, including both current and deferred components of income tax expense, for inclusion in its cost of service. Taxpayer also reduces its gross rate base by its ADIT balance to determine the rate base on which it is permitted to earn a return. Taxpayer’s accounting treatment for depreciation expense, income tax expense, ADIT, and rate base has been consistent with the Normalization Rules.

On December 22, 2017, the TCJA was signed into law. Among other changes, the TCJA reduced the federal corporate income tax rate from 35 percent to 21 percent for tax years beginning after December 31, 2017, Taxpayer’s calendar Year 1 tax year.

As a result of the tax reduction, the deferred taxes Taxpayer had accumulated at a 35 percent rate were reduced to those that would have been accumulated at a 21 percent rate had the 21 percent rate been in effect for all prior years. Because Taxpayer had a net deferred tax liability (“DTL”) on December 31, 2017, the tax rate reduction resulted in EDIT, because Taxpayer now expects to pay income taxes to the Department of the Treasury at the reduced 21 percent rate, as the timing differences that gave rise to its DTL reverse. In general, Taxpayer had collected the EDIT from customers through its traditional ratemaking methodology and not on a precise dollar-for-dollar basis. The 14-percentage point reduction in the tax rate is available to reduce the tax expense that Taxpayer included in setting customer rates. It is the timing of this reduction of the EDIT that is the issue of this ruling request.

Taxpayer maintains records that include the vintage records necessary to apply the average rate assumption method (“ARAM”). The total balance of Taxpayer’s EDIT is unknown. The annual amount of EDIT reversal under ARAM will vary each year, and this variance is unknown at this time. In general, this variability is caused by future events, including the time at which a vintage begins to reverse or when a vintage fully reverses. Taxpayer provides deferred taxes on plant-related timing differences whether or not those timing differences are protected by the Normalization Rules or unprotected by the Normalization Rules. Taxpayer and Commission A intend to apply ARAM to all plant-related timing differences. There is no dispute over this intent to apply ARAM. Throughout Taxpayer’s general rate case (“GRC”), these balances are commonly referred to as “protected plus” or “PP” to acknowledge the fact that ARAM is being applied not only to all protected EDIT, but also unproteced plant-related EDIT.

Taxpayer has been accounting for EDIT balances in ratemaking on a consistent method since the Tax Reform Act of 1986, Pub. L. No: 99-514 (“TRA 1986”). That method has been as follows:

> Taxpayer closes its books on a monthly basis. Each resulting monthly income statement and balance sheet contains its share of book depreciation, rate base, income tax expense, and ADIT (including EDIT). Taxpayer includes the ARAM reversal of EDIT in its monthly calculation of tax expense. Its EDIT balance is included in its ADIT to ensure that rate base is reduced by the proper amount of deferred taxes. This treatment ensures that book depreciation, income tax expense, ADIT, and rate base are computed consistently.
>
> Taxpayer’s rates are set periodically in a GRC using an historical test period. In a GRC, the accounting activity recorded in each month during the historical test year is the basis for setting customer rates, plus or minus any pro-forma adjustments. Once customer rates are established, they remain constant until the next GRC. At that next GRC, customer rates will be reset based on a new, different historical test year – different income and expenses (including income tax expense and book depreciation expense), different rate base, and different

> ADIT. The assumption underlying the use of an historical test year is that the costs and benefits in the historical period, plus or minus any pro-forma adjustments, will be representative of future periods during which customers will pay the rates. The process is intended to ensure that customer rates will be fair, just, reasonable, and sufficient. This is so even though the actual income and incurred costs, including EDIT reversals, for the period for which the rates are set will be different than those used to set the rates during the GRC.

In its Year 2 GRC, Taxpayer used calendar year Year 1 as the historical test year. This was its first GRC following the TCJA. In its monthly accounting activity throughout Year 1, Taxpayer recorded its EDIT reversal using ARAM. Those accounting entries had the effect of reducing Taxpayer's deferred tax expense and reduced Taxpayer's EDIT balance. No other entries were made with respect to EDIT. These entries were identical to those Taxpayer made since the tax rate reduction provided by the TRA 1986 to account for the EDIT created by the TRA 1986 tax rate reduction and used to set rates since that time.

In filing its Year 2 GRC, Taxpayper included the EDIT reversals that it recorded in calendar year Year 1, consistent with the use of Year 1 as the historical test period. In addition, its ADIT balance, including the EDIT, reflected these reversals. The accounting that occurred in calendar year Year 1 formed the basis for the amounts that Taxpayer proposed in setting rates for Year 2. In other words, the Year 1 book accounting provides the basis for ratemaking in the Year 2 GRC, which was originally intended to be effective for new rates beginning in mid-Year 3.

In response to Taxpayer's Year 2 GRC filing, Commission A issued Order on Date 1. Commission A did not follow Taxpayer's requested historical treatment. Instead, Commission A ordered the approach that raises the normalization issues that are the subject of this request.

Order requires Taxpayer to separately track EDIT on a tariff rate schedule independent of its rates set in its general rate order. In one requirement, Commission A requires the schedule to be updated annually for the reversal of the EDIT for the current year as if rates were set each year. Furthermore, in another requirement, Commission A requires Taxpayer to true-up for the difference between the EDIT amounts set in the schedule and the actual amount passed back due to volumetric variances. Commission A has ordered that the schedule must produce an annual adjustment to Taxpayer's rates for ARAM amortization of EDIT without any corresponding adjustment to Taxpayer's rates for annual changes in depreciation expense, income tax expense, rate base, or ADIT (including EDIT).

Order includes Taxpayer's depreciation expense, tax expense, ADIT (including EDIT), and rate base for the test year in the computation of the primary cost of service and base rate. Order then requries an adjustment to cost of service by removing the test year ARAM amortization of EDIT and substituting for that amount, as a reduction in cost of service, the estimated EDIT amortization for the year following the test year plus the next year which includes part of the rate year (in total, a 24-month period). No other similar adjustments are made for depreciation expense, income tax expense, ADIT (including EDIT), or rate base, which were, instead, based on the historical test period (again, not including pro forma adjustments which are not a topic of this PLR).

Order was applied to Taxpayer as follows: The test year was calendar year Year 1. The original rate year was to be Date 2 through Date 3, but the start of that rate period was initially delayed due to Coronavirus to an effective date of Date 4. After some further delays, the rates became effective Date 5, for gas operations and Date 6, for electric operations. Taxpayer's originally proposed ARAM EDIT amortization was based on the test year (calendar year Year 1). The Order adjustment was based on an estimate of ARAM EDIT amortization for the two-year period Date 7 through Date 8, the total two-year amount to be passed back in one year.

Taxpayer has proposed corrective action if the Service concludes that the EDIT treatment in Order is not consistent with a normalization method of accounting. If that determination is made, Taxpayer will need to reestablish a normalization method of accounting. In that event, Commission A has agreed to immediately open a proceeding upon Taxpayer's receipt of a PLR from the Service and revisit its order to comply with the Normalization Rules. This agreement was a condition of Taxpayer dismissing its judicial appeal of Order.

Taxpayer has taken additional action to ensure a quick and complete correction if Order is found inconsistent with the Normalization Rules. Taxpayer filed an accounting petition with Commission A on Date 5 in which it requested that Commission A allow Taxpayer to track the difference between Taxpayer's approach and the approach required in Order. The difference between the two approaches will be recorded to Taxpayer's balance sheet as a monthly entry. Two accounts will be used – a tracking account and a contra account (collectively, the "PLR Tracker Accounts"). The two accounts will net to zero and thereby have no impact on Taxpayer's financial results, as doing otherwise would not be in compliance with Commission A's order. However, the accounts will provide contemporaneous documentation of the variance between the two approaches.

For gas customers, rates consistent with Order went into effect on Date 5. For electric customers, new rates went into effect on Date 6. For both gas and electric customers, the accounting petition will provide Commission A with the ability to correct any normalization infraction that the IRS identifies in its ruling.

Taxpayer anticipates that any correction will involve two elements. The first element is a new tariff rate that will comply with the Service's ruling, which will be a new base tariff. That rate would continue in effect until Taxpayer's next rate-setting event, which is expected to be a GRC. The second element is a temporary tariff rate to bring the EDIT balance back into alignment with a normalization method of accounting. This second component would have the effect of reversing the amounts that were tracked in the PLR Tracker Accounts. The recovery of these balances would likely occur over a relatively short period.

RULINGS REQUESTED

Taxpayer requests rulings whether the accounting for EDIT as required by Order of Commission A is consistent with the Normalization Rules of § 168(i)(9), former § 167(l), and section 13004(d) of the TCJA. Specifically:

(1) Whether the Normalization Rules of § 168(i)(9), former § 167(l), and section 13001(d) of the TCJA permit Taxpayer to adjust its EDIT ARAM amortization based on the test year to the EDIT ARAM amortization based on one or more subsequent years without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense;

(2) Whether the Normalization Rules of § 168(i)(9), former § 167(l), and section 13001(d) of the TCJA permit Taxpayer to adjust its EDIT ARAM amortization annually without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense;

(3) Whether the Normalization Rules of § 168(i)(9), former § 167(l), and section 13001(d) of the TCJA permit Taxpayer to provide a true-up to EDIT ARAM amortization in the year following the rate year based on volume variances between the test year and the rate year without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense;

(4) Additionally, Taxpayer asks that if we determine that any of the requirements described of Order are not consistent with the Normalization Rules of § 168(i)(9), former § 167(l), and section 13001(d) of the TCJA, Taxpayer requests that we provide in the ruling that Taxpayer will not be considered to be in violation of the normalization rules if it follows the corrective actions described in its letter.

LAW AND ANALYSIS

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 § 167(l)(3)(G) in a manner consistent with that found in § 168(i)(9)(A). Section 1.167(l)-1(a)(1) provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under § 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

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

In order to use a normalization method of accounting, § 168(i)(9)(A) requires that a 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, 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.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of § 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 § 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 § 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 (hereinafter referred to as the "Consistency Rule").

Taxpayer's requests relate primarily to Taxpayer's compliance with the Consistency Rule. Taxpayer asks whether the Normalization Rules permit Taxpayer to adjust its EDIT ARAM amortization annually without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense. More specifically, Taxpayer also asks whether the Normalization Rules permit Taxpayer to adjust its EDIT ARAM amortization based on the test year to the EDIT ARAM amortization based on one or more subsequent years without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense. Lastly, Taxpayer asks whether the Normalization Rules permit Taxpayer to provide a true-up to EDIT ARAM amortization in the year following the rate year based on volume variances between the test year and the rate year without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense.

Therefore, the threshold question is whether the Consistency Rule applies to EDIT being accounted for under ARAM. Because these amounts were originally deferred pursuant to a normalization method of accounting, these amounts remain subject to the Normalization Rules of § 168(i)(9), former § 167(l), and section 13001(d) of the TCJA. Thus, if the EDIT being accounted for under ARAM is subject to Normalization Rules, the Consistency Rule must apply to the EDIT.

As described in § 168(i)(9)(B)(ii), the use of a procedure or adjustment that uses an estimate or projection of any of (1) the taxpayer's tax expense, (2) depreciation expense, or (3) reserve for deferred taxes under § 168(i)(9)(A)(ii), does not comply with the Consistency Rule 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. Therefore, generally, the Normalization Rules do not permit Taxpayer to adjust its EDIT ARAM amortization without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense**.** More specifically, in regard to request (1), the Normalization Rules do not allow Taxpayers to make an adjustment to cost of service by removing the test year ARAM amortization of EDIT and substituting for that amount, as a reduction in cost of service, the estimated EDIT amortization for the year following the test year plus the next year which includes part of the rate year (in total, a 24-month period) while also making no similar adjustments for depreciation, expense, income tax expense, ADIT (including EDIT), or rate base, which were based on the historical test period. In regard to request (2), the Normalization Rules do not allow Taxpayer to adjust its EDIT ARAM amortization annually without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense.

Additionally, in response to request (3), providing a true-up to EDIT ARAM amortization in the year following the rate year based on volume variances between the test year and the rate year without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense likewise is not in compliance with the Consistency Rule. The true-up mechanism adjusts for volume differences only with respect to one item, EDIT amortization. This results in the use of estimated volumes in setting rates for all items other than EDIT reversal which uses actual volumes. This treatment is an inconsistent use of estimates or projects not allowed by section 168(i)(9)(B).

The Normalization Rules were enacted in response to Congressional concerns over the growing number of public utility commissions that were mandating investor-owned regulated utilities to not retain these tax benefits from accelerated depreciation, but, instead, to immediately flow-through all of these tax incentives to ratepayers in the form of lower income tax expense in regulated cost of service rates. Congress' response was to enact legislation that would preclude regulated investor-owned utilities from utilizing accelerated depreciation methods of tax purposes if the related tax benefits were immediately flowed-through to ratepayers in rates or were flowed-through to ratepayers faster than permitted under the Normalization Rules.

The underlying concept and purpose of the Normalization Rules is to prevent the flow-through of these accelerated depreciation-related tax benefits to ratepayers in regulated rates any faster than permitted by the Normalization Rules. Thus, the flow-through of these tax benefits to ratepayers faster than permitted by the Normalization Rules would result in a normalization violation that would preclude the taxpayer from using any of the accelerated tax depreciation methods on public utility property and, instead, require the taxpayer to use the same depreciation method and period as those used to compute depreciation expense in its cost of service for ratemaking purposes. Conversely, a taxpayer that flows through these tax benefits to ratepayers slower than permitted by the Normalization Rules, or that never flows through any of the tax benefits from accelerated depreciation to ratepayers, would not be in violation of those rules.

By removing EDIT amortization for the test year and including the estimated EDIT amortization for the two following years, the EDIT amortization on the cost of service is higher than allowed under the ARAM limitation for the test year. This acceleration of the EDIT amortization occurs under the Order without any reduction to the EDIT balance which is taken into account in determining rate base. This provides customers not only with a lower cost of service through the acceleration of EDIT amortization but also a rate base which is artificially low because the EDIT credit balance included in rate base has not been reduced by the EDIT reversal that has been accelerated. This incorrectly provides customers with the double benefit of lower cost of service and lower rate base for the same EDIT.

Section 168(f)(2) provides that the depreciation deduction determined under § 168 shall not apply to any public utility property (within the meaning of § 168(i)(10)) if the taxpayer does not use a normalization method of accounting. However, in the legislative history to the enactment of the normalization requirements of the Investment Tax Credit (ITC), Congress 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. See also, Rev. Proc. 2017-47, 2017-38 I.R.B. 233, September 18, 2017.

Commission A has, at all times, required that utilities under its jurisdiction use normalization methods of accounting. Further, Commission A has agreed to immediately open a proceeding upon receipt of Taxpayer’s receipt of a PLR from the Service and revisit its order to comply with the Normalization Rules if the Service concludes that Order results in a rate calculation that is not consistent with the Normalization rules.

Taxpayer also intended at all times to comply with the Normalization Rules. Taxpayer has initiated the measures necessary to conform to the Normalization Rules. As noted, Taxpayer filed an accounting petition with Commission A in which it requested that Commission A allow Taxpayer to track the difference between Taxpayer’s approach and the approach required in Order. The difference between the two approaches will be recorded to Taxpayer’s balance sheet as a monthly entry identified as “the PLR Tracker Accounts.” For both gas and electric customers, the accounting petition provides

Commission A with the ability to correct any normalization infraction that the IRS identifies in this ruling.

Taxpayer's failure to comply with the Normalization Rules was inadvertent. Because the Commission, as well as Taxpayer, at all times sought to comply, and because corrective actions will be taken at the earliest available opportunity, it is not appropriate to conclude that the failure to follow the Consistency Rule for the EDIT that is a part of ADIT and calculated according to ARAM constituted a normalization violation and apply the sanction of denial of accelerated depreciation to Taxpayer.

CONCLUSION

Accordingly, we rule as follows:

(1) The Normalization Rules of § 168(i)(9), former § 167(l), and section 13001(d) of the TCJA do not permit Taxpayer to adjust its EDIT ARAM amortization based on the text year to the EDIT ARAM amortization based on one or more subsequent years without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense;

(2) The Normalization Rules of § 168(i)(9), former § 167(l), and section 13001(d) of the TCJA do not permit Taxpayer to adjust its EDIT ARAM amortization annually without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense.

(3) The Normalization Rules of § 168(i)(9), former § 167(l), and section 13001(d) of the TCJA do not permit Taxpayer to provide a true-up to EDIT ARAM amortization in the year following the rate year based on volume variances between the test year and the rate year without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense.

(4) While we have determined that the described requirements of Order are not consistent with the Normalization Rules of § 168(i)(9), former § 167(l), and section 13001(d) of the TCJA, Taxpayer will not be considered to be in violation of the normalization rules if it follows the corrective actions described in its letter.

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 who requested it. Section 6110(k)(3) of the Code provides 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 representative. We are also sending a copy of this letter ruling to the LB&I Policy Office.

Sincerely,

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

cc: