DAVID J. MEYER
VICE PRESIDENT AND CHIEF COUNSEL FOR
REGULATORY & GOVERNMENTAL AFFAIRS
AVISTA CORPORATION
P.O. BOX 3727
1411 EAST MISSION AVENUE
SPOKANE, WASHINGTON 99220-3727
TELEPHONE: (509) 495-4316
FACSIMILE: (509) 495-8851
DAVID.MEYER@AVISTACORP.COM

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF AVISTA CORPORATION FOR THE AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR ELECTRIC AND NATURAL GAS SERVICE TO ELECTRIC AND NATURAL GAS CUSTOMERS IN THE STATE OF IDAHO	)))))))	CASE NO. AVU-E-21-01 CASE NO. AVU-G-21-01 EXHIBIT NO. 4 OF RYAN L. KRASSELT

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

Proposed ADFIT Available to Flow Through		0.21		0.65		0.35			
		System		Electric		Electric - WA		Electric - ID	
FN		ADFIT	Grossed-Up (Rev. Req.)	ADFIT	Grossed-Up (Rev. Req.)	ADFIT	Grossed-Up (Rev. Req.)	ADFIT	Grossed-Up (Rev. Req.)
	Meters - 2019 Only	(11,378,988)	(14,403,782)	(6,710,083)	(8,493,776)	(4,361,554)	(5,520,955)	(2,348,529)	(2,972,822)
	Meters - 481(a) Prior Years	(12,076,466)	(15,286,665)	(2,881,535)	(3,647,513)	(1,872,998)	(2,370,883)	(1,008,537)	(1,276,629)
A	Meters - Amortization	2,419,978	3,063,263	1,233,767	1,561,730	801,948	1,015,125	431,818	546,606
B	Meters - Excess Deferreds	(2,754,681)	(3,486,938)	(407,309)	(515,581)	(264,751)	(335,128)	(142,558)	(180,453)
	IDD #5 - 2019 Only	(6,147,010)	(7,781,025)	(3,992,356)	(5,053,615)	(2,595,031)	(3,284,850)	(1,397,325)	(1,768,765)
	IDD #5 - 481(a) Prior Years	(70,924,333)	(89,777,637)	(47,469,315)	(60,087,740)	(30,855,055)	(39,057,031)	(16,614,260)	(21,030,709)
A	IDD #5 - Amortization	13,438,966	17,011,350	9,621,386	12,178,970	6,253,901	7,916,330	3,367,485	4,262,639
B	IDD #5 - Excess Deferreds	(18,786,790)	(23,780,746)	(12,084,267)	(15,296,540)	(7,854,773)	(9,942,751)	(4,229,493)	(5,353,789)
	Balance 12/31/2019	(106,209,323)	(134,442,181)	(62,689,712)	(79,354,066)	(40,748,313)	(51,580,143)	(21,941,399)	(27,773,923)
	2020 Estimated Future Annual Additions								
	IDD #5	(6,147,010)	(7,781,025)	(3,992,356)	(5,053,615)	(2,595,031)	(3,284,850)	(1,397,325)	(1,768,765)
	Meters	(9,648,925)	(12,213,830)	(5,721,117)	(7,241,920)	(3,718,726)	(4,707,248)	(2,002,391)	(2,534,672)
	Amortization	2,837,028	3,591,175	1,744,588	2,208,339	1,133,982	1,435,421	610,606	772,919
		(12,958,907)	(16,403,679)	(7,968,885)	(10,087,196)	(5,179,775)	(6,556,678)	(2,789,110)	(3,530,519)
	Estimated Balance 12/31/2020	(119,168,230)	(150,845,861)	(70,658,597)	(89,441,262)	(45,928,088)	(58,136,820)	(24,730,509)	(31,304,442)

A The amortization amounts represent the excess book depreciation over tax depreciation taken on the basis adjustments. (Since the basis adjustment has reduced the tax basis to zero, the tax depreciation is also zero.) Under normalization, deferred tax expense is recorded on the book depreciation and reduces the deferred tax liability in FERC Account No. 282900.

B Excess deferreds are associated with asset vintages placed in service prior to the 2018 tax reform when the statutory tax rate changed from 35% to 21%. Since the method changes include basis adjustments on prior year assets, there is an excess deferred amount associated with the new basis adjustments that is considered unprotected and can be flowed through to customers.

Exhibit No. 4
Case Nos. AVU-E-21-01 & AVU-G-21-01
R. Krasselt, Avista
Schedule 1, Page 1 of 2

Proposed ADFIT Available to Flow Through				0.7		0.3			
		Gas North		Gas North - WA		Gas North - ID		Oregon	
FN		ADFIT	Grossed-Up (Rev. Req.)	ADFIT	Grossed-Up (Rev. Req.)	ADFIT	Grossed-Up (Rev. Req.)	ADFIT	Grossed-Up (Rev. Req.)
	Meters - 2019 Only	(3,770,938)	(4,773,339)	(2,639,657)	(3,341,338)	(1,131,281)	(1,432,002)	(897,967)	(1,136,667)
	Meters - 481(a) Prior Years	(6,103,632)	(7,726,116)	(4,272,542)	(5,408,281)	(1,831,090)	(2,317,835)	(3,091,299)	(3,913,036)
A	Meters - Amortization	932,955	1,180,956	653,069	826,669	279,887	354,287	253,255	320,576
B	Meters - Excess Deferreds	(1,404,734)	(1,778,144)	(983,314)	(1,244,701)	(421,420)	(533,443)	(942,638)	(1,193,213)
	IDD #5 - 2019 Only	(1,489,312)	(1,885,206)	(1,042,519)	(1,319,644)	(446,794)	(565,562)	(665,341)	(842,204)
	IDD #5 - 481(a) Prior Years	(14,857,618)	(18,807,111)	(10,400,332)	(13,164,978)	(4,457,285)	(5,642,133)	(8,597,401)	(10,882,786)
A	IDD #5 - Amortization	2,663,298	3,371,263	1,864,308	2,359,884	798,989	1,011,379	1,154,283	1,461,118
B	IDD #5 - Excess Deferreds	(4,046,151)	(5,121,710)	(2,832,305)	(3,585,197)	(1,213,845)	(1,536,513)	(2,656,373)	(3,362,497)
	Balance 12/31/2019	(28,076,131)	(35,539,407)	(19,653,292)	(24,877,585)	(8,422,839)	(10,661,822)	(15,443,480)	(19,548,709)
	2020 Estimated Future Annual Additi								
	IDD #5	(1,489,312)	(1,885,206)	(1,042,519)	(1,319,644)	(446,794)	(565,562)	(665,341)	(842,204)
	Meters	(3,081,644)	(3,900,815)	(2,157,151)	(2,730,570)	(924,493)	(1,170,244)	(846,164)	(1,071,094)
	Amortization	820,966	1,039,198	574,677	727,439	246,290	311,759	271,474	343,638
		(3,749,990)	(4,746,823)	(2,624,993)	(3,322,776)	(1,124,997)	(1,424,047)	(1,240,032)	(1,569,661)
	Estimated Balance 12/31/2020	(31,826,121)	(40,286,229)	(22,278,285)	(28,200,361)	(9,547,836)	(12,085,869)	(16,683,512)	(21,118,369)

Exhibit No. 4
Case Nos. AVU-E-21-01 & AVU-G-21-01
R. Krasselt, Avista
Schedule 1, Page 2 of 2

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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

Index Number: 168.24-01

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

In Re:

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

Department of the Treasury
Washington, DC 20224

Number: **202010002**
Release Date: 3/6/2020

Index Number: 168.24-01

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B06
PLR-113227-19
Date: December 3, 2019

In Re:

LEGEND:

Taxpayer	=
Parent	=
State A	=
State B	=
Commission	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Date 8	=
Date 9	=

Date 10 =

Date 11 =

Date 12 =

Date 13 =

Date 14 =

Date 15 =

Date 16 =

Month 1 =

Month 2 =

Month 3 =

Month 4 =

Month 5 =

Month 6 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

a =

b =

c =

d =

e =

f =

g =
h =

i =

j =

k =

l =

Dear :

This letter responds to a request for a private letter ruling dated June 5, 2019, and submitted on behalf of Taxpayer for rulings under § 168(i)(9) of the Internal Revenue Code and § 1.167(l)-1 of the Income Tax Regulations (together, the "Normalization Rules") regarding the scope of the deferred tax normalization requirements and the appropriate methodology for the reduction of the accumulated deferred income tax ("ADIT") balance that decreases rate base computation when a net operating loss carryforward ("NOLC") exists. The relevant facts as represented in your submission are set forth below.

FACTS

Taxpayer files a consolidated federal income tax return on a calendar year basis with its affiliates, including its Parent. Taxpayer uses the accrual method of accounting.

Parent is incorporated in State A, and Taxpayer is incorporated in State B. Parent is a water and wastewater utility company. Taxpayer is the affiliate that operates in State B. Prices charged by Taxpayer are set by Commission. Commission sets rates that Taxpayer may charge for the furnishing or sale of water or sewage disposal services through a combination of periodic general rate case proceedings (resulting in what are commonly referred to as "base rates") and infrastructure surcharge proceedings (resulting in surcharges that are added to base rates.)

The most recent two base rate changes resulting from general rate case authorizations by Commission affecting water and wastewater revenue requirements were effective in Month 1 Year 1 and Month 2 Year 2. The most recent three rate changes resulting from infrastructure surcharge authorizations by Commission were effective in Month 3 Year 3, Month 4 Year 4 and Month 4 Year 2. Taxpayer questions whether the rates set pursuant to the most recent infrastructure surcharge proceeding comply with the deferred tax normalization requirements.

Infrastructure surcharges are regulatory mechanisms to permit recovery of capital investments and results in adjustments to rates charged outside of a general rate case for specified costs and investments. Under State B statute and Commission rulemaking, eligible water corporations may petition Commission and utilize a Infrastructure System Replacement Surcharge ("Surcharge") to recover the costs of eligible water utility main replacements and relocations.

For both general rate case proceedings and Surcharge proceedings, Taxpayer computes a revenue requirement subject to Commission approval based on recovery of a debt- and equity-based return on investment in rate base, including the cost of plant assets less accumulated book depreciation and ADIT, and a recovery of operating expenses, including depreciation expense, property tax expense, and income tax expense. For Surcharge proceedings, rate base is determined based on incremental plant expenditures incurred during a historical measurement period (not necessarily 12 months) ending shortly before rates become effective, less accumulated book depreciation and ADIT computed as of a date subsequent to the date at which gross plant is computed and closer to (but preceding) the date that rates become effective. For Surcharge proceedings, operating expenses include 12 months of annualized depreciation expense on the incremental investment in the Surcharge proceeding and any property taxes that will be paid within 12 months of filing the Surcharge application.

The deferred tax normalization matters in this request arose during the Surcharge proceeding initiated by Taxpayer in Month 5 Year 2 and resulting in a Commission order on Date 1 (the "Surcharge Case"). The Surcharge resulting from the Surcharge Case became effective on Date 2. Some of the normalization matters addressed in this ruling request related to deductions and ADIT resulting from the consent agreement that Parent received from the Service on Date 3, on behalf of itself and various affiliates, including Taxpayer, with respect to changes in tax method of accounting for costs to repair and maintain tangible property and dispositions of certain tangible depreciable property ("Consent Agreement").

State B statutes and Commission B rules provide eligible water corporations with the ability to recover certain infrastructure system replacement costs outside of a formal rate case filing via a Surcharge. A petition must be filed with the Commission for review and approval before an adjustment can be made to a water corporation's rates and charges to provide for the recovery of the costs associated with eligible infrastructure system replacements. A State B statute authorizes Commission to enter an order authorizing the water corporation to impose a Surcharge that is sufficient to recover appropriate pretax revenues. The State B statute defines the revenue requirement set in a Surcharge proceeding and provides that "appropriate pretax revenues" are the revenues necessary to produce net operating income equal to the water corporation's weighted cost of capital multiplied by the net original cost of eligible infrastructure system replacements, including recognition of accumulated deferred income taxes and accumulated depreciation associated with eligible infrastructure system

replacements. . .” among other items. Taxpayer represents that Commission and the State B courts have interpreted this statute in a strict manner thereby limiting the costs eligible for recovery or to earn a return in a Surcharge proceeding and causing costs not eligible for ratemaking consideration in a Surcharge proceeding to only be eligible for recovery or return in the next base rate proceeding.

Taxpayer, per its petition filed with Commission on Date 4, sought to establish a Surcharge rate to provide for the recovery of actual costs for eligible infrastructure system replacements and relocations from Date 5 through Date 6, and estimated investment accounts for Date 7 through Date 8. During the course of the Surcharge case, Taxpayer provided Commission with actual expenditures for Month 5 and Month 6. The proposed Surcharge rate schedule reflected the pre-tax Surcharge revenues necessary to produce net operating income equal to Taxpayer’s weighted cost of capital multiplied by the original cost of the requested infrastructure replacements that are eligible for the Surcharge, reduced by net ADIT and accumulated depreciation associated with eligible infrastructure system replacements through Date 9. Taxpayer also sought to recover all state, federal and local income or excise taxes applicable to such Surcharge income and to recover all other Surcharge costs including annualized depreciation expense and property taxes due within 12 months.

The specific test period and service period information pertaining to the Surcharge Case is:

- Rates became effective Date 2
- Actual gross plant was based on additions of certain property placed in service from Date 5 through Date 8
- Accumulated depreciation on such assets was estimated through Date 9
- Estimated ADIT related to depreciation book/tax differences associated with such expenditures to the extent also capitalized for tax purposes was computed through Date 9
- Estimated ADIT related to repair book/tax differences associated with such expenditures to the extent not capitalized for tax purposes was computed through Date 9
- Recoverable operating expenses were estimated for the period beginning Date 10 and ending Date 9

In a Surcharge proceeding, replacement mains and associated valves and hydrants comprise the plant assets included in rate base and result in the accumulated depreciation reducing rate base and the recoverable depreciation expense. The expenditures for replacement mains and associated valves addressed in a Surcharge proceeding are capitalizable for regulatory accounting purposes, but may result in a repair deduction for tax purposes or depreciable plant for tax purposes. The ADIT balance reducing rate base in a Surcharge proceeding is caused by depreciation-related and repair-related book/tax differences.

The key issues in the Surcharge case and, thus, in this ruling request, pertain to whether the tax effect of an NOLC must, pursuant to the normalization requirements, decrease the ADIT reduction to rate base related to the expenditures in the Surcharge case and, if so, the methodology to determine the amount of the NOLC adjustment subject to the normalization requirements. The return on rate base is based on the pre-tax rate of return authorized in the most recent rate order resulting from a general rate proceeding.

In the course of the Surcharge Case, Taxpayer and other participants in the proceeding analyzed the expenditures for which Taxpayer sought recovery via the Surcharge and debated the proper regulatory treatment of Taxpayer's NOLC and tax loss incurred through the rate base determination date of the Surcharge case with respect to the costs incurred that are recoverable in the Surcharge case. The revenue requirement approved in Commission's order issued on Date 1 was lower than the revenue requirement sought by Taxpayer and is entirely attributable to differing ADIT calculations with respect to the NOLC and the resulting effects on rate base and allowed return. The approved revenue requirement in the Surcharge case was based on a rate base computation that reflects the gross ADIT liabilities associated with depreciation-related and repair-related book/tax differences, but did not reflect an ADIT asset for any portion of Taxpayer's NOLC as of the date that rate base was determined (Date 9) , including the tax loss resulting from the infrastructure expenditures addressed in the Surcharge Case.

On a consolidated basis, Parent incurred tax losses in various years from Year 5 to Year 1 and, as of Date 11, had an NOLC of approximately $a. On a separate company basis, Taxpayer incurred tax losses in various tax years from Year 5 – Year 1 and, as of Date 11, had a separate company NOLC of approximately $b. For Year 2, Parent (on a consolidated basis) and Taxpayer (on a separate company basis) estimate that taxable income was earned and, thus, NOLC was utilized.

The revenue requirement related to the Surcharge Case is approximately $c (pursuant to the rate order). Taxpayer asserts that the revenue requirement should have been computed to be $d. The difference in the revenue requirement computations relates entirely to the exclusion of Taxpayer's NOLC from rate base. As of the date of the rate base determination, none of the Surcharge revenues had been billed to customers and, thus, as of such date, a taxable loss of approximately $e had been incurred with respect to the plant-related expenditures with rates set by the Surcharge Case.

During the loss years resulting in Taxpayer's NOLC estimated as of the end of the test period for the Surcharge Case, separate company deductible depreciation-related book/tax differences were approximately $f and separate company deductible repair-related book/tax differences were approximately $g (plus the § 481(a) adjustment with respect to the tax accounting method changes subject to the Consent agreement deducted in Year 5 of approximately $h.

The NOLC reflected in ratemaking for the base rate case proceeding with rates effective in Month 2 Year 2 was based on the estimated NOLC as of the end of Year 4 of $i, including an estimated Year 4 tax loss of $j. The actual Year 4 tax loss reported on the Year 4 tax return was $k. The excess of the actual Year 4 tax loss over the estimated Year 4 tax loss of $l has yet to be reflected in ratemaking.

On Date 12, Taxpayer filed an Application for Rehearing and Motion to Defer Ruling, asking the Commission for the time to seek a private letter ruling form of guidance from the Service to address any uncertainties regarding the application of the deferred tax normalization requirements to the rate base treatment of the NOLC-related ADIT asset in computing the Surcharge case revenue requirement. On Date 13, the Commission denied Taxpayer's request for rehearing. Taxpayer filed a notice of appeal by Date 14, that initiated an appeal of the order in the Surcharge case to the State B Court of Appeals. Taxpayer anticipates receiving a private letter ruling from the Service prior to the State B Court of Appeals issuing a final opinion in Taxpayer's appeal of the Commission denial of Taxpayer's Motion for Rehearing. If the Service rules that the Commission's decision in Taxpayer's Surcharge case ordered a method of regulatory accounting that is inconsistent with the deferred tax normalization requirements, Taxpayer believes that the Commission and Taxpayer would be procedurally able to correct the revenue requirement in a manner that compensates Taxpayer for any foregone revenue requirement relative to ADIT and rate base computations that comply with the normalization requirements.

Because Taxpayer is concerned that the order issued by Commission as part of the Surcharge case on Date 1, and the prices that became effective on Date 2, are inconsistent with the deferred tax normalization requirements, Taxpayer submitted a letter to the Service on Date 14 intended to provide the notification pursuant to § 1.167(l)-1(h)(5) of the Regulations.

As noted, on Date 3, Taxpayer's parent corporation received the Consent Agreement from the Internal Revenue Service granting certain of its subsidiaries, including Taxpayer, permission to change their (1) method of accounting for costs to repair and maintain tangible property from capitalizing and depreciating these costs to deducting these costs under § 162 of the Internal Revenue Code, and (2) unit of property for determining dispositions of depreciable network assets from using a method other than the functional interdependence test to using the functional interdependence test to determine the units of property. These changes in methods of accounting were effective for the taxable year beginning Date 15, and ended Date 16 (the "year of change").

These changes in methods of accounting resulted in an overall net negative § 481(a) adjustment for Taxpayer as stated in the Consent Agreement. This overall net negative § 481(a) adjustment consists of a net negative § 481(a) adjustment for the

repair and maintenance change in method of accounting and a net positive § 481(a) adjustment for the disposition change in method of accounting.

The Service's consent to the above changes in methods of accounting is subject to several terms and conditions stated in the Consent Agreement. Condition nine of the Consent Agreement requires that if any item of property subject to the taxpayer's Form 3115 is public utility property within the meaning of § 168(i)(10) or former § 167(I)(3)(A): (A) a normalization method of accounting (within the meaning of § 168(i)(9), former § 168(e)(3)(B), or former § 167(I)(3)(G), as applicable) must be used for the public utility property subject to the Form 3115; (B) as of the beginning of the year of change, the taxpayer must adjust its deferred tax reserve account or similar reserve account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to the public utility property subject to the Form 3115; and (C) within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer must provide a copy of the Form 3115 (and any additional information submitted to the Service in connection with such Form 3115) to any regulatory body having jurisdiction over the public utility property subject to the Form 3115. See page 6 of the Consent Agreement.

Based on Taxpayer's interpretation of this condition in the Consent Agreement, Taxpayer has applied the normalization requirements to its repair-related and disposition-related deferred tax computations in rate proceedings since the year of change.

Prior to the year of change (Year 5), Taxpayer depreciated public utility property that was in service as of the end of the taxable year immediately preceding the year of change using different book and tax methods and lives. As a result, an amount of ADIT subject to the normalization requirements was recorded prior to the above changes in methods of accounting for repairs and dispositions (depreciation-related ADIT).

Differing assertions were made as part of the Surcharge Case. Ultimately the Commission in its final order determined that because there was not an NOL expected to be generated in Year 4, no portion of the NOLC deferred tax asset can be associated with the Surcharge property.

RULINGS REQUESTED

1) The property otherwise depreciable under § 168(a) and for which cost recovery and return on investment initially occur as part of the Surcharge Case, rather than as part of base rates set in less frequent general rate case proceedings, constitutes public utility property within the meaning of § 168(i)(10).

2) The ADIT amounts used in computing the revenue requirement set in the Surcharge Case with respect to public utility property within the meaning of § 168(i)(10)

must comply with the normalization method of accounting within the meaning of § 168(i)(9).

3) For any public utility property within the meaning of § 168(i)(10) as of the end of the tax year immediately preceding the year of change for the changes in tax method of accounting subject to Taxpayer's Consent Agreement, the depreciation-related ADIT prior to the change in tax method of accounting for repairs and dispositions remains subject to the normalization method of accounting within the meaning of § 168(i)(9) after implementation of the new tax method of accounting.

4) For any public utility property within the meaning of § 168(i)(10) and subject to Taxpayer's Consent Agreement, the ADIT resulting from the repair-related § 481(a) adjustment is not subject to the normalization method of accounting within the meaning of § 168(i)(9).

5) The ADIT resulting from expenditures (1) related to an item of property includible in rate base and recoverable as regulatory depreciation expense in the determination of the revenue requirement set in the Surcharge Case and (2) deducted as repairs under § 162 to public utility property within the meaning of § 168(i)(10), or a predecessor provision of the normalization requirements, pursuant to the tax method of accounting for repairs permitted in Taxpayer's Consent Agreement, is not subject to the normalization method of accounting within the meaning of § 168(i)(9) or, as applicable, a predecessor statutory provision.

6) The ADIT resulting from book/tax differences related to depreciable method and life for public utility property that exists at the date of a retirement of the property for regulatory accounting purposes in a transaction involving a replacement or relocation that is not treated as a disposition under Taxpayer's tax method of accounting for dispositions permitted in Taxpayer's Consent Agreement remains subject to the normalization method of accounting within the meaning of § 168(i)(9) after the book-only retirement.

7) For any public utility property within the meaning of § 168(i)(10) for which a disposition had been recognized for tax purposes in a tax year prior to the tax year of change for the changes in tax method of accounting subject to Taxpayer's Consent Agreement and for which the taxable gain or loss upon such disposition was reversed as part of the disposition-related § 481(a) adjustment, the ADIT related to the restored tax basis of such public utility property is subject to the normalization method of accounting within the meaning of § 168(i)(9), despite the book-only retirement.

8) If the Service rules as Taxpayer has requested with respect to issue # 5 and holds that ADIT resulting from repair-related book/tax differences is not subject to the normalization requirements, Taxpayer requests that the Service also rule: In order to comply with the normalization method of accounting within the meaning of § 168(i)(9), the amount of depreciation-related ADIT reducing rate base used to determine the

revenue requirement set in the Surcharge Case is limited to the amount of depreciation-related deferred tax expense recovered in rates as of the Surcharge Case rate base determination date.

9) If the Service rules as Taxpayer has requested with respect to issue # 5 and holds that ADIT resulting from repair-related book/tax differences is not subject to the normalization requirements, Taxpayer requests that the Service also rule: Under the circumstances described above, in order to comply with the normalization method of accounting within the meaning of § 168(i)(9), the amount of depreciation-related ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case must be decreased to reflect a portion of the NOL for the test period for the Surcharge Case which would not have arisen had Taxpayer not reported depreciation-related book/tax differences during the text period for the Surcharge Case and such decrease in depreciation-related ADIT must be an amount that is no less than the amount computed using the With-and-Without Method.

10) If the Service (a) rules as Taxpayer has requested with respect to issue # 5 and holds that ADIT resulting from repair-related book/tax differences is not subject to the normalization requirements, but (b) does not grant ruling # 9 in accordance with Taxpayer's analysis, Taxpayer requests that the Service instead rule: Under the circumstances described above, in order to comply with the normalization method of accounting within the meaning of § 168(i)(9), the amount of depreciation-related ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case must be decreased to reflect a portion of the NOLC which would not have arisen (or an increase in such NOLC which would not have arisen) had Taxpayer not reported depreciation-related book/tax differences during the test period for the Surcharge Case and such decrease in depreciation-related ADIT must be an amount that is no less than the amount computed using the With-and-Without Method but only to the extent that the NOLC has not reduced depreciation-related ADIT in rate base computation in another rate proceeding with prices still in effect.

11) If the Service rules as Taxpayer has requested with respect to issue # 5 and holds that ADIT resulting from repair-related book/tax differences is not subject to the normalization requirements, Taxpayer requests that the Service also rule: Under the circumstances described above, in order to comply with the normalization method of accounting within the meaning of § 168(i)(9), it is not necessary to decrease ADIT or otherwise increase rate base for the Surcharge Case by the portion of the NOLC which would not have arisen (or an increase in such NOLC which would not have arisen) had Taxpayer not reported depreciation-related book/tax differences in prior periods or during the test period for the Surcharge Case with respect to public utility property with rates not set by the Surcharge Case.

12) If the Service does not rule as Taxpayer has requested with respect to issue # 5 and holds that ADIT resulting from repair-related book/tax differences is subject to the normalization requirements, Taxpayer requests that the Service also rule: Under

the circumstances described above, in order to comply with the normalization method of accounting within the meaning of § 168(i)(9), the amount of ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case must be decreased to reflect the portion of the Surcharge Case test period NOL which would not have arisen had Taxpayer not reported the depreciation-related book/tax difference or repair-related book/tax difference permitted in Taxpayer's Consent Agreement with respect to expenditures with ratemaking determined pursuant to the Surcharge Case, by an amount that is no less than the amount computed using the With-and-Without Method. If, instead, the Service rules as Taxpayer has requested with respect to issue # 5, ruling request # 12 would be moot.

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.

Section 168(i)(10) defines, in part, public utility property as property used predominantly in the trade or business of the furnishing or sale of electrical energy if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof.

Prior to the Revenue Reconciliation Act of 1990, the definition of public utility property was contained in § 167(l)(3)(A) and § 168(i)(10), which defined public utility property by means of a cross reference to § 167(l)(3)(A). The definition of public utility property is unchanged. Section 1.167(l)-1(b) provides that under § 167(l)(3)(A), property is public utility property during any period in which it is used predominantly in a § 167(l) public utility activity. The term "section 167(l) public utility activity" means, in part, the trade or business of the furnishing or sale of electrical energy if the rates for such furnishing or sale, as the case may be, are regulated, i.e., have been established or approved by a regulatory body described in § 167(l)(3)(A). The term "regulatory body described in § 167(l)(3)(A)" means a State (including the District of Columbia) or political subdivision thereof, any agency or instrumentality of the United States or a public service or public utility commission or other body of any State or political subdivision thereof similar to such a commission. The term "established or approved" includes the filing of a schedule of rates with a regulatory body which has the power to approve such rates, though such body has taken no action on the filed schedule or generally leaves undisturbed rates filed by the taxpayer.

The definitions of public utility property contained in § 168(i)(10) and former § 46(f)(5) are essentially identical. Section 1.167(l)-1(b) restates the statutory definition providing that property will be considered public utility property if it is used predominantly in a public utility activity and the rates are regulated. Section 1.167(l)-1(b)(1) provides that rates are regulated for such purposes if they are established or approved by a regulatory body. The terms established or approved are further defined

to include the filing of a schedule of rates with the regulatory body that has the power to approve such rates, even if the regulatory body has taken no action on the filed schedule or generally leaves undisturbed rates filed.

The regulations under former § 46, specifically § 1.46-3(g)(2), expand the definition of regulated rates. The expanded definition embodies the notion of rates established or approved on a rate of return basis. This notion is not specifically provided for in the regulations under former § 167. Nevertheless, there is an expressed reference to rate of return in § 1.167(l)-1(h)(6)(i). The operative rules for normalizing timing differences relating to use of different methods and periods of depreciation are only logical in the context of rate of return regulation. The normalization method, which must be used for public utility property to be eligible for the depreciation allowance available under § 168, is defined in terms of the method the taxpayer uses in computing its tax expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account. Thus, for purposes of applying the normalization rules, the definition of public utility property is the same for purposes of the investment tax credit and depreciation.

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

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

Section 168(i)(9)(B)(i) 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 (referred to as the “Consistency Rule”).

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 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.

Section 1.167(l)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a subsection (1) method for purposes of determining the taxpayer's reasonable allowance under § 167(a) results in a net operating loss carryover to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under § 167(a) using a subsection (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

Section 1.167(l)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under § 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under § 1.167(l)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under § 167(a).

Section 1.167(l)-1(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of

regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under § 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.

Section 1.167(l)-1(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under § 1.167(l)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so. Section 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.

Section 1.167(l)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements of former § 167(l) with respect to public utility property defined in former § 167(l)(3)(A) 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.

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.

Regarding ruling requests 1 and 2, the key factors in determining whether property is public utility property are that (1) the property must be used predominantly in the trade or business of the furnishing or sale of, inter alia, water and wastewater; (2) the rates for such furnishing or sale must be established or approved by a State or political subdivision thereof, any agency or instrumentality of the United States, or by a public service or public utility commission or similar body of any State or political subdivision thereof; and (3) the rates so established or approved must be determined on a rate-of-return basis. State B statutes and Commission B rules provide eligible water corporations with the ability to recover certain infrastructure system replacement costs outside of a formal rate case filing via a Surcharge. These infrastructure system replacements will be predominantly used in the trade or business of the furnishing or sale of water and wastewater and therefore, it will possess the first of the three characteristics. Moreover, as a regulated public utility subject to the jurisdiction of federal or state law, including the ratemaking jurisdiction of the State B commission, the second requirement is met. Lastly, as evidenced by the facts, these rates are determined on a rate-of-return basis. After establishing that this involves public utility property, the law makes clear that the depreciation deduction determined under § 168

shall not apply to any public utility property if the taxpayer does not use a normalization method of accounting. The normalization regulations require a taxpayer to credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account.

Taxpayer's ruling request 3 pertains to the depreciation-related ADIT existing prior to the year of change ( ) 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 Consent Agreement granted Taxpayer permission to change its (1) method of accounting for costs to repair and maintain tangible property from capitalizing and depreciating these costs to deducting these costs under § 162, and (2) unit of property for determining dispositions of depreciable network assets from using a method other than the functional interdependence test to using the functional interdependence test to determine the units of property.

As stated previously, condition nine of the Consent Agreement provides that if any item of property subject to the Form 3115 is public utility property within the meaning of § 168(i)(10), a normalization method of accounting (within the meaning of § 168(i)(9)) must be used for such public utility property. Public utility property (within the meaning of § 168(i)(10)) is a depreciable asset. Consequently, condition nine of the Consent Agreement is intended to apply to Taxpayer's public utility property that continues to be depreciated for federal income tax purposes under Taxpayer's new method of accounting for the year of change and subsequent taxable years.

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 ( ), the depreciation-related ADIT existing prior to the year of change for the changes in methods of accounting subject to the 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.

As stated previously under ruling request 3, condition nine of the Consent Agreement is intended to apply to Taxpayer's public utility property that continues to be depreciated for federal income tax purposes under Taxpayer's new method of

accounting for the year of change and subsequent taxable years. A repair expense is an item of expense that is deductible under § 162 and for which depreciation is not allowable. Accordingly, the ADIT resulting from the repair-related § 481(a) adjustment is not subject to the normalization method of accounting within the meaning of § 168(i)(9).

Similarly, condition nine of the Consent Agreement is intended to apply to Taxpayer's public utility property that continues to be depreciated for federal income tax purposes under Taxpayer's new method of accounting for the year of change and subsequent taxable years. A repair expense is an item of expense that is deductible under § 162 and for which depreciation is not allowable. Accordingly, ADIT resulting from expenditures (1) related to an item of property includible in rate base and recoverable as regulatory depreciation expense in the determination of the revenue requirement set in the Surcharge Case and (2) deducted as repairs under § 162 to public utility property within the meaning of § 168(i)(10), or a predecessor provision of the normalization requirements, pursuant to the tax method of accounting for repairs permitted in Taxpayer's Consent Agreement, is not subject to the normalization method of accounting within the meaning of § 168(i)(9) or, as applicable, a predecessor statutory provision.

Regarding ruling request 6, § 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. Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Section 1.167(l)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under § 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under § 1.167(l)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under § 167(a). In this case, the transaction involves a replacement or relocation that is not treated as a disposition under Taxpayer's tax method of accounting. The depreciation-related ADIT existing immediately prior to a transaction considered a retirement for regulatory accounting purposes but not treated as a disposition for federal income tax purposes continues to be subject to the

normalization requirements because adjusted tax basis is not affected and the § 168(a) depreciation deductions continue.

For ruling request 7, as stated previously under ruling request 3, condition nine of the Consent Agreement is intended to apply to Taxpayer's public utility property that continues to be depreciated for federal income tax purposes under Taxpayer's new method of accounting for the year of change and subsequent taxable years. Accordingly, the ADIT resulting from the disposition-related § 481(a) adjustment and related to the restored tax basis of public utility property that was treated as disposed under the old method of accounting but is not treated as disposed under the new method of accounting is subject to the normalization method of accounting within the meaning of § 168(i)(9).

Regarding ruling requests 8, 9, and 11, generally, Taxpayer is arguing that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax during the Surcharge Case test period due to the presence of the NOLC. The normalization requirements pertain **only** to deferred income taxes for public utility property resulting from the use of accelerated depreciation for tax purposes and the use of straight-line depreciation for establishing cost of service and reflecting the operating results in regulated books of account. Generally, amounts that do not actually defer tax because of the existence of an NOL need to be reflected as offsetting entries to the ADIT account to show the portion of tax losses which did not actually defer tax due to accelerated depreciation.

Section 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the reserve account for deferred taxes (ADIT), reduces rate base, it is clear that the portion of the net operating loss carryover (NOLC) that is attributable to accelerated depreciation must be taken into account in calculating the amount of the ADIT account balance. Thus, the ADIT asset resulting from the NOLC should be included in rate base, given the inclusion in rate base of the full amount of the ADIT liability resulting from accelerated tax depreciation.

Section 1.167(l)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes. Section 1.167(l)-1(h)(1)(iii) provides generally that, if, in respect of any year, the use of other than regulatory depreciation for tax purposes results in an NOLC carryover (or an increase in an NOLC which would not have arisen had the taxpayer claimed only regulatory depreciation for tax purposes), then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director. The "with or without" methodology suggested by Taxpayer is specifically designed to ensure that the

portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers.

Taxpayer also raises the issue of the computation of the amount by which depreciation-related Taxpayer's NOLC as of the rate base determination date for the Surcharge Case must be included in rate base. This focuses on whether the NOLC taken into account in the Surcharge Case is limited to depreciation-related book/tax differences related to expenditures reflected in the Surcharge Case or must also reflect the full net increase in depreciation-related NOLC occurring since the rate base determination date of the immediately preceding base rate proceeding. In this case, based on the State B statute, the revenue requirement of a Surcharge Case is limited to the following income tax amounts: ADIT associated with property-related costs for property with rates set by the Surcharge Case and income taxes applicable to the Surcharge Case revenue requirement. The normalization requirements do not require that all incremental NOLC arising since the most recent general rate proceeding must be reflected in an interim (here a Surcharge) proceeding. Instead, the normalization requirements permit an increase in NOLC resulting from non-Surcharge Case public utility property to be disregarded for the Surcharge Case and considered in the next rate proceeding that reflects the depreciation expense and rate base inclusion of the public utility property resulting in the depreciation-related book/tax differences included in the NOLC.

Based on the foregoing, we conclude that:

1) The property otherwise depreciable under § 168(a) and for which cost recovery and return on investment initially occur as part of the Surcharge Case, rather than as part of base rates set in less frequent general rate case proceedings, constitutes public utility property within the meaning of § 168(i)(10).

2) The ADIT amounts used in computing the revenue requirement set in the Surcharge Case with respect to public utility property within the meaning of § 168(i)(10) must comply with the normalization method of accounting within the meaning of § 168(i)(9).

3) For any public utility property within the meaning of § 168(i)(10) of the Code as of the end of the tax year immediately preceding the year of change for the changes in tax method of accounting subject to Taxpayer's Consent Agreement, the depreciation-related ADIT prior to the change in tax method of accounting for repairs and dispositions is not subject to the normalization method of accounting within the meaning of § 168(i)(9) of the Code after implementation of the new tax method of accounting.

4) For any public utility property within the meaning of § 168(i)(10) and subject to Taxpayer's Consent Agreement, the ADIT resulting from the repair-related § 481(a)

adjustment is not subject to the normalization method of accounting within the meaning of § 168(i)(9).

5) The ADIT resulting from expenditures (1) related to an item of property includible in rate base and recoverable as regulatory depreciation expense in the determination of the revenue requirement set in the Surcharge Case and (2) deducted as repairs under § 162 to public utility property within the meaning of § 168(i)(10), or a predecessor provision of the normalization requirements, pursuant to the tax method of accounting for repairs permitted in Taxpayer's Consent Agreement, is not subject to the normalization method of accounting within the meaning of § 168(i)(9) or, as applicable, a predecessor statutory provision.

6) The ADIT resulting from book/tax differences related to depreciable method and life for public utility property that exists at the date of a retirement of the property for regulatory accounting purposes in a transaction involving a replacement or relocation that is not treated as a disposition under Taxpayer's tax method of accounting for dispositions permitted in Taxpayer's Consent Agreement remains subject to the normalization method of accounting within the meaning of § 168(i)(9) after the book-only retirement.

7) For any public utility property within the meaning of § 168(i)(10) for which a disposition had been recognized for tax purposes in a tax year prior to the tax year of change for the changes in tax method of accounting subject to Taxpayer's Consent Agreement and for which the taxable gain or loss upon such disposition was reversed as part of the disposition-related § 481(a) adjustment, the ADIT related to the restored tax basis of such public utility property is subject to the normalization method of accounting within the meaning of § 168(i)(9), despite the book-only retirement.

8) In order to comply with the normalization method of accounting within the meaning of § 168(i)(9), the amount of depreciation-related ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case is limited to the amount of depreciation-related deferred tax expense recovered in rates as of the Surcharge Case rate base determination date.

9) Under the circumstances described, in order to comply with the normalization method of accounting within the meaning of § 168(i)(9), the amount of depreciation-related ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case must be decreased to reflect a portion of the NOL for the test period for the Surcharge Case which would not have arisen had Taxpayer not reported depreciation-related book/tax differences during the text period for the Surcharge Case and such decrease in depreciation-related ADIT must be an amount that is no less than the amount computed using the With-and-Without Method.

10) Ruling request 10 is moot because we grant ruling 9 in accordance with Taxpayer's analysis.

11) Under the circumstances described above, in order to comply with the normalization method of accounting within the meaning of § 168(i)(9), it is not necessary to decrease ADIT or otherwise increase rate base for the Surcharge Case by the portion of the NOLC which would not have arisen (or an increase in such NOLC which would not have arisen) had Taxpayer not reported depreciation-related book/tax differences in prior periods or during the test period for the Surcharge Case with respect to public utility property with rates not set by the Surcharge Case.

12) Ruling request 12 is moot because we rule as Taxpayer requests with respect to ruling request 5.

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)

AVISTA CORP.

Form 3115, Application for Change of Accounting Method

METERS

Change in method of accounting for non-incidental materials and supplies under Treas. Reg. § 1.162-3(a) effective for the taxable year ended December 31, 2019 under the automatic consent procedures of Rev. Proc. 2019-43.

Form **3115**
(Rev. December 2018)
Department of the Treasury
Internal Revenue Service

Application for Change in Accounting Method

▶ **Go to www.irs.gov/Form3115 for instructions and the latest information.**

OMB No. 1545-2070

Name of filer (name of parent corporation if a consolidated group) (see instructions)	**Identification number** (see instructions)
AVISTA CORPORATION	**91-0462470**
	Principal business activity code number (see instructions) **221100**
Number, street, and room or suite no. If a P.O. box, see the instructions. **1411 EAST MISSION AVENUE**	Tax year of change begins (MM/DD/YYYY) **1/1/2019** Tax year of change ends (MM/DD/YYYY) **12/31/2019**
City or town, state, and ZIP code **SPOKANE, WA 99202**	Name of contact person (see instructions) **JANE ROHRS**
Name of applicant(s) (if different than filer) and identification number(s) (see instructions) **N/A**	Contact person's telephone number **(202) 370-2290**

If the applicant is a member of a consolidated group, check this box . . . . . ▶ [X]

If **Form 2848**, Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box . . . . . ▶ [X]

Check the box to indicate the type of applicant.

- [ ] Individual
- [X] Corporation
- [ ] Controlled foreign corporation (Sec. 957)
- [ ] 10/50 corporation (Sec. 904(d)(2)(E))
- [ ] Qualified personal service corporation (Sec. 448(d)(2))
- [ ] Exempt organization. Enter Code section ▶
- [ ] Cooperative (Sec. 1381)
- [ ] Partnership
- [ ] S corporation
- [ ] Insurance co. (Sec. 816(a))
- [ ] Insurance co. (Sec. 831)
- [ ] Other (specify) ▶

Check the appropriate box to indicate the type of accounting method change being requested.
See instructions.

- [ ] Depreciation or Amortization
- [ ] Financial Products and/or Financial Activities of Financial Institutions
- [X] Other (specify) ▶ **NON-INCIDENTAL MATERIALS AND SUPPLIES**

Caution: To be eligible for approval of the requested change in method of accounting, the taxpayer must provide all information that is relevant to the taxpayer or to the taxpayer's requested change in method of accounting. This includes **(1)** all relevant information requested on this Form 3115 (including its instructions), and **(2)** any other relevant information, even if not specifically requested on Form 3115.

The taxpayer must attach all applicable statements requested throughout this form.

Part I Information For Automatic Change Request	Yes	No
1 Enter the applicable designated automatic accounting method change number ("DCN") for the requested automatic change. Enter only one DCN, except as provided for in guidance published by the IRS. If the requested change has no DCN, check "Other," and provide both a description of the change and a citation of the IRS guidance providing the automatic change. See instructions.		
a (1) DCN: **186** (2) DCN: (3) DCN: (4) DCN: (5) DCN: (6) DCN: (7) DCN: (8) DCN: (9) DCN: (10) DCN: (11) DCN: (12) DCN:		
b Other [ ] Description ▶		
2 Do any of the eligibility rules restrict the applicant from filing the requested change using the automatic change procedures (see instructions)? If "Yes," attach an explanation.		X
3 Has the filer provided all the information and statements required **(a)** on this form and **(b)** by the List of Automatic Changes under which the applicant is requesting a change? See instructions.	X	
Note: Complete Part II and Part IV of this form, and, Schedules A through E, if applicable.		

Part II Information For All Requests	Yes	No
4 During the tax year of change, did or will the applicant **(a)** cease to engage in the trade or business to which the requested change relates, or (b) terminate its existence? See instructions.		X
5 Is the applicant requesting to change to the principal method in the tax year of change under Regulations section 1.381(c)(4)-1(d)(1) or 1.381(c)(5)-1(d)(1)?		X
If "No," go to line 6a. If "Yes," the applicant cannot file a Form 3115 for this change. See instructions.		

Sign Here

Under penalties of perjury, I declare that I have examined this application, including accompanying schedules and statements, and to the best of my knowledge and belief, the application contains all the relevant facts relating to the application, and it is true, correct, and complete. Declaration of preparer (other than applicant) is based on all information of which preparer has any knowledge.

Signature of filer (and spouse, if joint return)	Date	Name and title (print or type)
▶ Daniel Loutzenhiser	10/1/2020	**DANIEL LOUTZENHISER - ASSISTANT TREASURER**

Preparer (other than filer/applicant)

Print/Type preparer's name	Preparer's signature	Date
MATTHEW MCKINNEY	Matthew N. McKinney	10/6/2020
Firm's name ▶ **DELOITTE TAX LLP**		

Part II	Information For All Requests *(continued)*	Yes	No
6a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) under examination (see instructions)?		X
	If "No," go to line 7a.		
b	Is the method of accounting the applicant is requesting to change an issue under consideration (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s))? See instructions.	N/A	
c	Enter the name and telephone number of the examining agent and the tax year(s) under examination. N/A Name ► _____ Telephone number ► _____ Tax year(s) ► _____		
d	Has a copy of this Form 3115 been provided to the examining agent identified on line 6c?	N/A	
7a	Does audit protection apply to the applicant's requested change in the method of accounting? See instructions.	X	
	If "No," attach an explanation.		
b	If "Yes," check the applicable box and attach the required statement. [X] Not under exam [ ] 3-month window [ ] 120 day: Date examination ended ► ..... [ ] Method not before director [X] Negative adjustment [ ] CAP: Date member joined group ► ..... [ ] Audit protection at end of exam [ ] Other		
8a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) before Appeals and/or a federal court?		X
	If "No," go to line 9.		
b	Is the method of accounting the applicant is requesting to change an issue under consideration by Appeals and/or a federal court (for either the applicant or any present or former consolidated group in which the applicant was a member for the tax year(s) the applicant was a member)? See instructions.	N/A	
	If "Yes," attach an explanation.		
c	If "Yes," enter the name of the (check the box) [ ] Appeals officer and/or [ ] counsel for the government, telephone number, and the tax year(s) before Appeals and/or a federal court. N/A Name ► _____ Telephone number ► _____ Tax year(s) ► _____		
d	Has a copy of this Form 3115 been provided to the Appeals officer and/or counsel for the government identified on line 8c?	N/A	
9	If the applicant answered "Yes" to line 6a and/or 8a with respect to any present or former consolidated group, attach a statement that provides each parent corporation's **(a)** name, **(b)** identification number, **(c)** address, and **(d)** tax year(s) during which the applicant was a member that is under examination, before an Appeals office, and/or before a federal court. N/A		
10	If for federal income tax purposes, the applicant is either an entity (including a limited liability company) treated as a partnership or an S corporation, is it requesting a change from a method of accounting that is an issue under consideration in an examination, before Appeals, or before a federal court, with respect to a federal income tax return of a partner, member, or shareholder of that entity?	N/A	
11a	Has the applicant, its predecessor, or a related party requested or made (under either an automatic or non-automatic change procedure) a change in method of accounting within any of the five tax years ending with the tax year of change?	X	
	If "No," go to line 12.		
b	If "Yes," for each trade or business, attach a description of each requested change in method of accounting (including the tax year of change) and state whether the applicant received consent. SEE ATTACHMENT		
c	If any application was withdrawn, not perfected, or denied, or if a Consent Agreement granting a change was not signed and returned to the IRS, or the change was not made or not made in the requested year of change, attach an explanation. N/A		
12	Does the applicant, its predecessor, or a related party currently have pending any request (including any concurrently filed request) for a private letter ruling, change in method of accounting, or technical advice?		X
	If "Yes," for each request attach a statement providing **(a)** the name(s) of the taxpayer, **(b)** identification number(s), **(c)** the type of request (private letter ruling, change in method of accounting, or technical advice), and **(d)** the specific issue(s) in the request(s).		
13	Is the applicant requesting to change its **overall** method of accounting?		X
	If "Yes," complete Schedule A on page 4 of this form.		

Part II	Information For All Requests *(continued)*	Yes	No
14	If the applicant is either **(i) not** changing its overall method of accounting, or **(ii)** is changing its overall method of accounting **and** changing to a special method of accounting for one or more items, attach a detailed and complete description for each of the following (see instructions): **SEE ATTACHMENT**		
a	The item(s) being changed.		
b	The applicant's present method for the item(s) being changed.		
c	The applicant's proposed method for the item(s) being changed.		
d	The applicant's present overall method of accounting (cash, accrual, or hybrid).		
15a	Attach a detailed and complete description of the applicant's trade(s) or business(es). See section 446(d). **SEE ATTACHMENT**		
b	If the applicant has more than one trade or business, as defined in Regulations section 1.446-1(d), describe **(i)** whether each trade or business is accounted for separately; **(ii)** the goods and services provided by each trade or business and any other types of activities engaged in that generate gross income; **(iii)** the overall method of accounting for each trade or business; and **(iv)** which trade or business is requesting to change its accounting method as part of this application or a separate application. **N/A** **Note:** If you are requesting an automatic method change, see the instructions to see if you are required to complete Lines 16a-16c.		
16a	Attach a full explanation of the legal basis supporting the proposed method for the item being changed. Include a detailed and complete description of the facts that explains how the law specifically applies to the applicant's situation and that demonstrates that the applicant is authorized to use the proposed method. **N/A**		
b	Include all authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method. **N/A**		
c	Include either a discussion of the contrary authorities or a statement that no contrary authority exists. **N/A**		
17	Will the proposed method of accounting be used for the applicant's books and records and financial statements? For insurance companies, see the instructions		X
	If "No," attach an explanation. **SEE ATTACHMENT**		
18	Does the applicant request a conference with the IRS National Office if the IRS National Office proposes an adverse response?	X	
19a	If the applicant is changing to either the overall cash method, an overall accrual method, or is changing its method of accounting for any property subject to section 263A, any long-term contract subject to section 460 (see 19b), or inventories subject to section 474, enter the applicant's gross receipts for the 3 tax years preceding the tax year of change. **N/A**		

1st preceding year ended: mo. yr.	2nd preceding year ended: mo. yr.	3rd preceding year ended: mo. yr.
$	$	$

b	If the applicant is changing its method of accounting for any long-term contract subject to section 460, in addition to completing 19a, enter the applicant's gross receipts for the 4th tax year preceding the tax year of change: **N/A** 4th preceding year ended: mo. _____ yr. _____ $ _____		

Part III	Information For Non-Automatic Change Request **N/A**	Yes	No
20	Is the applicant's requested change described in any revenue procedure, revenue ruling, notice, regulation, or other published guidance as an automatic change request?		
	If "Yes," attach an explanation describing why the applicant is submitting its request under the non-automatic change procedures.		
21	Attach a copy of all documents related to the proposed change (see instructions).		
22	Attach a statement of the applicant's reasons for the proposed change.		
23	If the applicant is a member of a consolidated group for the year of change, do all other members of the consolidated group use the proposed method of accounting for the item being changed?		
	If "No," attach an explanation.		
24a	Enter the amount of **user fee** attached to this application (see instructions). ► $ _____		
b	If the applicant qualifies for a reduced user fee, attach the required information or certification (see instructions).		

Exhibit No. 4
Case Nos. AVU-E-21-01 & AVU-G-21-01
R. Krasselt, Avista
Schedule 3, Page 3 of 27

Part IV	Section 481(a) Adjustment	Yes	No
25	Does published guidance require the applicant (or permit the applicant and the applicant is electing) to implement the requested change in method of accounting on a cut-off basis? . . . . . If "Yes," attach an explanation and do not complete lines 26, 27, and 28 below.		X
26	Enter the section 481(a) adjustment. Indicate whether the adjustment is an increase (+) or a decrease (-) in income. ► $ **-30,930,774** Attach a summary of the computation and an explanation of the methodology used to determine the section 481(a) adjustment. If it is based on more than one component, show the computation for each component. If more than one applicant is applying for the method change on the application, attach a list of the **(a)** name, **(b)** identification number, and **(c)** the amount of the section 481(a) adjustment attributable to each applicant. **SEE ATTACHMENT**		
27	Is the applicant making an election to take the entire amount of the adjustment into account in the tax year of change? If "Yes," check the box for the applicable elective provision used to make the election (see instructions). ☐ $50,000 de minimis election ☐ Eligible acquisition transaction election		X
28	Is any part of the section 481(a) adjustment attributable to transactions between members of an affiliated group, a consolidated group, a controlled group, or other related parties? . . . . . If "Yes," attach an explanation.		X

Schedule A — Change in Overall Method of Accounting (If Schedule A applies, Part I below must be completed.) **N/A**

Part I Change in Overall Method (see instructions)

1 Check the appropriate boxes below to indicate the applicant's present and proposed methods of accounting.
Present method: ☐ Cash ☐ Accrual ☐ Hybrid (attach description)
Proposed method: ☐ Cash ☐ Accrual ☐ Hybrid (attach description)

2 Enter the following amounts as of the close of the tax year preceding the year of change. If none, state "None." Also, attach a statement providing a breakdown of the amounts entered on lines 2a through 2g.

		Amount
a	Income accrued but not received (such as accounts receivable)	$
b	Income received or reported before it was earned (such as advanced payments). Attach a description of the income and the legal basis for the proposed method	
c	Expenses accrued but not paid (such as accounts payable)	
d	Prepaid expenses previously deducted	
e	Supplies on hand previously deducted and/or not previously reported	
f	Inventory on hand previously deducted and/or not previously reported. Complete Schedule D, Part II	
g	Other amounts (specify). Attach a description of the item and the legal basis for its inclusion in the calculation of the section 481(a) adjustment. ►	
h	**Net section 481(a) adjustment** (Combine lines 2a-2g.) Indicate whether the adjustment is an increase (+) or decrease (-) in income. Also enter the net amount of this section 481(a) adjustment amount on Part IV, line 26	$ -

3 Is the applicant also requesting the recurring item exception under section 461(h)(3)? . . . . . ☐ **Yes** ☐ **No**

4 Attach copies of the profit and loss statement (Schedule F (Form 1040) for farmers) and the balance sheet, if applicable, as of the close of the tax year preceding the year of change. Also attach a statement specifying the accounting method used when preparing the balance sheet. If books of account are not kept, attach a copy of the business schedules submitted with the federal income tax return or other return (such as, tax-exempt organization returns) for that period. If the amounts in Part I, lines 2a through 2g, do not agree with the amounts shown on both the profit and loss statement and the balance sheet, attach a statement explaining the differences.

5 Is the applicant making a change to the overall cash method as a small business taxpayer (see instructions)? . . . ☐ **Yes** ☐ **No**

Part II Change to the Cash Method For Non-Automatic Change Request (see instructions)

Applicants requesting a change to the cash method must attach the following information:

1 A description of inventory items (items whose production, purchase, or sale is an income-producing factor) and materials and supplies used in carrying out the business.

2 An explanation as to whether the applicant is required to use the accrual method under any section of the Code or regulations.

Schedule B — Change to the Deferral Method for Advance Payments (see instructions) **N/A**

1 If the applicant is requesting to change to the deferral method for advance payments, as described in the instructions, attach the following information:

a Explain how the advance payments meet the definition of advance payment, as described in the instructions.

b Does the taxpayer use an applicable financial statement as described in the instructions and, if so, identify it.

c Describe the taxpayer's allocation method, if there is more than one performance obligation, as defined in the instructions.

d Describe the taxpayer's legal basis for deferral. See instructions.

e If the applicant is filing under the non-automatic change procedures, see the instructions for the information required.

Schedule C — Changes Within the LIFO Inventory Method (see instructions) **N/A**

Part I General LIFO Information

Complete this section if the requested change involves changes within the LIFO inventory method. Also, attach a copy of all **Forms 970,** Application To Use LIFO Inventory Method, filed to adopt or expand the use of the LIFO method.

1 Attach a description of the applicant's present and proposed LIFO methods and submethods for each of the following items:

a Valuing inventory (for example, unit method or dollar-value method).

b Pooling (for example, by line or type or class of goods, natural business unit, multiple pools, raw material content, simplified dollar-value method, inventory price index computation (IPIC) pools, vehicle-pool method, etc.).

c Pricing dollar-value pools (for example, double-extension, index, link-chain, link-chain index, IPIC method, etc.).

d Determining the current-year cost of goods in the ending inventory (such as, most recent acquisitions, earliest acquisitions during the current year, average cost of current-year acquisitions, rolling-average cost, or other permitted method).

2 If any present method or submethod used by the applicant is not the same as indicated on Form(s) 970 filed to adopt or expand the use of the method, attach an explanation.

3 If the proposed change is not requested for all the LIFO inventory, attach a statement specifying the inventory to which the change is and is not applicable.

4 If the proposed change is not requested for all of the LIFO pools, attach a statement specifying the LIFO pool(s) to which the change is applicable.

5 Attach a statement addressing whether the applicant values any of its LIFO inventory on a method other than cost. For example, if the applicant values some of its LIFO inventory at retail and the remainder at cost, identify which inventory items are valued under each method.

6 If changing to the IPIC method, attach a completed Form 970.

Part II Change in Pooling Inventories

1 If the applicant is proposing to change its pooling method or the number of pools, attach a description of the contents of, and state the base year for, each dollar-value pool the applicant presently uses and proposes to use.

2 If the applicant is proposing to use natural business unit (NBU) pools or requesting to change the number of NBU pools, attach the following information (to the extent not already provided) in sufficient detail to show that each proposed NBU was determined under Regulations sections 1.472-8(b)(1) and (2):

a A description of the types of products produced by the applicant. If possible, attach a brochure.

b A description of the types of processes and raw materials used to produce the products in each proposed pool.

c If all of the products to be included in the proposed NBU pool(s) are not produced at one facility, state the reasons for the separate facilities, the location of each facility, and a description of the products each facility produces.

d A description of the natural business divisions adopted by the taxpayer. State whether separate cost centers are maintained and if separate profit and loss statements are prepared.

e A statement addressing whether the applicant has inventories of items purchased and held for resale that are not further processed by the applicant, including whether such items, if any, will be included in any proposed NBU pool.

f A statement addressing whether all items including raw materials, goods-in-process, and finished goods entering into the entire inventory investment for each proposed NBU pool are presently valued under the LIFO method. Describe any items that are not presently valued under the LIFO method that are to be included in each proposed pool.

g A statement addressing whether, within the proposed NBU pool(s), there are items both sold to unrelated parties and transferred to a different unit of the applicant to be used as a component part of another product prior to final processing.

3 If the applicant is engaged in manufacturing and is proposing to use the multiple pooling method or raw material content pools, attach information to show that each proposed pool will consist of a group of items that are substantially similar. See Regulations section 1.472-8(b)(3).

4 If the applicant is engaged in the wholesaling or retailing of goods and is requesting to change the number of pools used, attach information to show that each of the proposed pools is based on customary business classifications of the applicant's trade or business. See Regulations section 1.472-8(c).

Schedule D — Change in the Treatment of Long-Term Contracts Under Section 460, Inventories, or Other Section 263A Assets (see instructions) **N/A**

Part I **Change in Reporting Income From Long-Term Contracts** (Also complete Part III on pages 7 and 8.)

1 To the extent not already provided, attach a description of the applicant's present and proposed methods for reporting income and expenses from long-term contracts. Also, attach a representative actual contract (without any deletion) for the requested change. If the applicant is a construction contractor, attach a detailed description of its construction activities.

2a Are the applicant's contracts long-term contracts as defined in section 460(f)(1) (see instructions)? ☐ **Yes** ☐ **No**

b If "Yes," do all the contracts qualify for the exception under section 460(e) (see instructions)? ☐ **Yes** ☐ **No**
If line 2b is "No," attach an explanation.

c Is the applicant requesting to use the percentage-of-completion method using cost-to-cost under Regulations section 1.460-4(b)? ☐ **Yes** ☐ **No**

d If line 2c is "Yes," in computing the completion factor of a contract, will the applicant use the simplified cost-to-cost method described in Regulations section 1.460-5(c)? ☐ **Yes** ☐ **No**

e If line 2c is "No," is the applicant requesting to use the exempt-contract percentage-of-completion method under Regulations section 1.460-4(c)(2)? ☐ **Yes** ☐ **No**
If line 2e is "Yes," attach an explanation of what method the applicant will use to determine a contract's completion factor.
If line 2e is "No," attach an explanation of what method the applicant is using and the authority for its use.

3a Does the applicant have long-term manufacturing contracts as defined in section 460(f)(2)? ☐ **Yes** ☐ **No**

b If "Yes," attach a description of the applicant's manufacturing activities, including any required installation of manufactured goods.

4a Does the applicant enter into cost-plus long-term contracts? ☐ **Yes** ☐ **No**

b Does the applicant enter into federal long-term contracts? ☐ **Yes** ☐ **No**

Part II **Change in Valuing Inventories Including Cost Allocation Changes** (Also complete Part III on pages 7 and 8.)

1 Attach a description of the inventory goods being changed.

2 Attach a description of the inventory goods (if any) NOT being changed.

3a Is the applicant subject to section 263A? If "No," go to line 4a ☐ **Yes** ☐ **No**

b Is the applicant's present inventory valuation method in compliance with section 263A (see instructions)? If "No," attach a detailed explanation ☐ **Yes** ☐ **No**

4a Check the appropriate boxes in the chart.

	Inventory Method Being Changed		Inventory Method Not Being Changed
Identification methods:	Present method	Proposed method	Present method
Specific identification			
FIFO			
LIFO			
Other (attach explanation)			
Valuation methods:			
Cost			
Cost or market, whichever is lower			
Retail cost			
Retail, lower of cost or market			
Other (attach explanation)			

b Enter the value at the end of the tax year preceding the year of change. $ $

5 If the applicant is changing from the LIFO inventory method to a non-LIFO method, attach the following information (see instructions).

a Copies of Form(s) 970 filed to adopt or expand the use of the method.

b **Only for applicants requesting a non-automatic change.** A statement describing whether the applicant is changing to the method required by Regulations section 1.472-6(a) or (b), or whether the applicant is proposing a different method.

c **Only for applicants requesting an automatic change.** The statement required by section 23.01(5) of Rev. Proc. 2018-31 (or its successor).

Exhibit No. 4
Case Nos. AVU-E-21-01 & AVU-G-21-01
R. Krasselt, Avista
Schedule 3, Page 6 of 27

Part III **Method of Cost Allocation** (Complete this part if the requested change involves either property subject to section 263A or long-term contracts as described in section 460). See instructions

Section A — Allocation and Capitalization Methods

Attach a description (including sample computations) of the present and proposed method(s) the applicant uses to capitalize direct and indirect costs properly allocable to real or tangible personal property produced and property acquired for resale, or to allocate direct and indirect costs required to be allocated long-term contracts. Include a description of the method(s) used for allocating indirect costs to intermediate cost objectives such as departments or activities prior to the allocation of such costs to long-term contracts, real or tangible personal property produced, and property acquired for resale. The description must include the following:

1 The method of allocating direct and indirect costs (for example, specific identification, burden rate, standard cost, or other reasonable allocation method).

2 The method of allocating mixed service costs (for example, direct reallocation, step-allocation, simplified service cost using the labor-based allocation ratio, simplified service cost using the production cost allocation ratio, or other reasonable allocation method).

3 Except for long-term contract accounting methods, the method of capitalizing additional section 263A costs (for example, simplified production with or without the historic absorption ratio election, simplified resale with or without the historic absorption ratio election including permissible variations, the U.S. ratio, or other reasonable allocation method).

Section B — Direct and Indirect Costs Required to be Allocated

Check the appropriate boxes showing the costs that are or will be fully included, to the extent required, in the cost of real or tangible personal property produced or property acquired for resale under section 263A or allocated to long-term contracts under section 460. Mark "N/A" in a box if those costs are not incurred by the applicant. If a box is not checked, it is assumed that those costs are not fully included to the extent required. Attach an explanation for boxes that are not checked.

		Present method	Proposed method
1	Direct material		
2	Direct labor		
3	Indirect labor		
4	Officers' compensation (not including selling activities)		
5	Pension and other related costs		
6	Employee benefits		
7	Indirect materials and supplies		
8	Purchasing costs		
9	Handling, processing, assembly, and repackaging costs		
10	Offsite storage and warehousing costs		
11	Depreciation, amortization, and cost recovery allowance for equipment and facilities placed in service and not temporarily idle		
12	Depletion		
13	Rent		
14	Taxes other than state, local, and foreign income taxes		
15	Insurance		
16	Utilities		
17	Maintenance and repairs that relate to a production, resale, or long-term contract activity		
18	Engineering and design costs (not including section 174 research and experimental expenses)		
19	Rework labor, scrap, and spoilage		
20	Tools and equipment		
21	Quality control and inspection		
22	Bidding expenses incurred in the solicitation of contracts awarded to the applicant		
23	Licensing and franchise costs		
24	Capitalizable service costs (including mixed service costs)		
25	Administrative costs (not including any costs of selling or any return on capital)		
26	Research and experimental expenses attributable to long-term contracts		
27	Interest		
28	Other costs (Attach a list of these costs.)		

Part III **Method of Cost Allocation** *(continued)* See instructions.

Section C — Other Costs Not Required To Be Allocated (Complete Section C only if the applicant is requesting to change its method for these costs.)

		Present method	Proposed method
1	Marketing, selling, advertising, and distribution expenses		
2	Research and experimental expenses not included in Section B, line 26		
3	Bidding expenses not included in Section B, line 22		
4	General and administrative costs not included in Section B		
5	Income taxes		
6	Cost of strikes		
7	Warranty and product liability costs		
8	Section 179 costs		
9	On-site storage		
10	Depreciation, amortization, and cost recovery allowance not included in Section B, line 11		
11	Other costs (Attach a list of these costs.)		

Schedule E — Change in Depreciation or Amortization. See instructions. **N/A**

Applicants requesting approval to change their method of accounting for depreciation or amortization complete this section. Applicants ***must*** provide this information for each item or class of property for which a change is requested.

Note: See the ***Summary of the List of Automatic Accounting Method Changes*** in the instructions for information regarding automatic changes under sections 56, 167, 168, 197, 1400I, 1400L, or former section 168. **Do not** file Form 3115 with respect to certain late elections and election revocations. See instructions.

1 Is depreciation for the property determined under Regulations section 1.167(a)-11 (CLADR)? ☐ **Yes** ☐ **No**
If "Yes," the only changes permitted are under Regulations section 1.167(a)-11(c)(1)(iii).

2 Is any of the depreciation or amortization required to be capitalized under any Code section such as, section 263A? ☐ **Yes** ☐ **No**
If "Yes," enter the applicable section ►

3 Has a depreciation, amortization, expense, or disposition election been made for the property such as the election under sections 168(f)(1), 168(i)(4), 179, 179C, or Regulations section 1.168(i)-8(d)? ☐ **Yes** ☐ **No**
If "Yes," state the election made ►

4a To the extent not already provided, attach a statement describing the property subject to the change. Include in the description the type of property, the year the property was placed in service, and the property's use in the applicant's trade or business or income-producing activity.

b If the property is residential rental property, did the applicant live in the property before renting it? ☐ **Yes** ☐ **No**

c Is the property public utility property? ☐ **Yes** ☐ **No**

5 To the extent not already provided in the applicant's description of its present method, attach a statement explaining how the property is treated under the applicant's present method (for example, depreciable property, inventory property, supplies under Regulations section 1.162-3, nondepreciable section 263(a) property, property deductible as a current expenses, etc.).

6 If the property is not currently treated as depreciable or amortizable property, attach a statement of the facts supporting the proposed change to depreciate or amortize the property.

7 If the property is currently treated and/or will be treated as depreciable or amortizable property, provide the following information for both the present (if applicable) and proposed methods:

a The Code section under which the property is or will be depreciated or amortized (for example, section 168(g)).

b The applicable asset class from Rev. Proc. 87-56, 1987-2 C.B. 674, for each asset depreciated under section 168 (MACRS) or under section 1400L; the applicable asset class from Rev. Proc. 83-35, 1983-1 C.B. 745, for each asset depreciated under former section 168 (ACRS); an explanation why no asset class is identified for each asset for which an asset class has not been identified by the applicant.

c The facts to support the asset class for the proposed method.

d The depreciation or amortization method of the property, including the applicable Code section (for example, 200% declining balance method under section 168(b)(1)).

e The useful life, recovery period, or amortization period of the property.

f The applicable convention of the property.

g Whether the additional first-year special depreciation allowance (for example, as provided by section 168(k), 168(l), 168(m), 168(n), 1400L(b), or 1400N(d)) was or will be claimed for the property. If not, also provide an explanation as to why no special depreciation allowance was or will be claimed.

h Whether the property was or will be in a single asset account, a multiple asset account, or a general asset account.

Part II, Question 11b – Accounting Method Changes in the Past Five Years

Avista Corporation (EIN: 91-0462470) is changing its method of accounting for prepaid expenses under Treas. Reg. § 1.263(a)-3 effective for the taxable year ended December 31, 2019 under the automatic consent procedures of Rev. Proc. 2019-43.

Avista Corporation (EIN: 91-0462470) is changing its method of accounting for depreciation effective for the taxable year ended December 31, 2019 under the automatic consent procedures of Rev. Proc. 2019-43.

Avista Corporation (EIN: 91-0462470) is changing its method of accounting for costs under I.R.C. § 263A effective for the taxable year ended December 31, 2019 under the automatic consent procedures of Rev. Proc. 2019-43.

Avista Corporation (EIN: 91-0462470) is changing its method of accounting for deducting repairs and maintenance costs and its method of identifying the unit of property, effective for the taxable year ended December 31, 2019 under the automatic consent procedures of Rev. Proc. 2019-43.

Part II, Question 14 – Description of Proposed Change

a. The Applicant is changing its method of accounting for amounts paid to acquire non-incidental materials and supplies, as defined in Treas. Reg. §§ 1.162-3(a)(1) and (c)(1), that are used or consumed in the Applicant's trade or business. The items that are the subject of this request are meters, including the cost of equipment and installation. The meters are materials and supplies under Treas. Reg. § 1.162-3(c)(1) in that they have an acquisition cost of $200 or less. The items are non-incidental under Treas. Reg. § 1.162-3(a)(2) because the Applicant takes a physical inventory of these items at the beginning and end of the tax year. The cost of the materials and supplies are not required to be capitalized to inventory under I.R.C. § 263A.

   The Applicant has not adopted the International Financial Reporting Standards ("IFRS") and the proposed change is not related to the adoption of IFRS.

b. Under its present method of accounting, the Applicant capitalizes the non-incidental materials and supplies and depreciates the capitalized costs under I.R.C. § 168, using a 20-year recovery period, the 150% declining balance method, and a half-year or mid-quarter convention. The 20-year recovery period is based on the classification as Electric Utility Transmission and Distribution Plant property or Gas Utility Distribution Facilities property, pursuant to Rev. Proc. 87-56. Furthermore, the Applicant has claimed the additional first year depreciation under I.R.C. § 168(k), as applicable, provided it did not affirmatively elect not to claim such depreciation. The Applicant has not claimed any federal tax credit related to the item being changed.

c. Under its proposed method of accounting, the Applicant will deduct non-incidental materials and supplies as defined under Treas. Reg. §§ 1.162-3(a)(1) and (c)(1)(iv) when they are first used or consumed in the Applicant's operations in accordance with Treas. Reg. § 1.162-3(c)(1), taking into account Treas. Reg. § 1.162-3(b).

d. The Applicant's overall method of account is an accrual method.

Part II, Question 15a – Description of Trade or Business

The Applicant is a regulated electric and gas utility company engaged in the generation, transmission, and distribution. The Applicant is also involved in the sale of electricity and the distribution of natural gas. Its

principal business activity code is 221100. The Applicant has a single trade or business as described in Treas. Reg. § 1.446-1(d).

Part II, Question 17 – Book-Tax Conformity

The Applicant will not use the proposed method of account for its books and records or its financial statements because the proposed method does not conform to Generally Accepted Accounting Principles ("GAAP").

Part IV, Question 26 – Section 481(a) Adjustment

The net negative I.R.C. § 481(a) adjustment of ($30,930,774) is equal to the adjusted tax basis of the materials and supplies as of the first day of the tax year of change. There is no I.R.C. § 263A impact.

Request for Facsimile Transmission Pursuant to Section 9.04(3) of Rev. Proc. 2020-1

The Applicant hereby requests that a facsimile transmission of any document related to this Form 3115 be sent to the Applicant and the Applicant's authorized representatives as follows:

Applicant	**Fax Number**
Daniel Loutzenhiser	(509) 777-5642

Applicant's Representatives	**Fax Number**
Jane Rohrs	(877) 501-2599
Matt McKinney	(704) 285-6654
Jon Ryan	(855) 320-9645

AVISTA CORP.

Form 3115, Application for Change of Accounting Method

IDD#5

Change in method of accounting for costs under I.R.C. § 263A effective for the taxable year ended December 31, 2019 under the automatic consent procedures of Rev. Proc. 2019-43.

Form **3115**
(Rev. December 2018)
Department of the Treasury
Internal Revenue Service

Application for Change in Accounting Method

▶ **Go to www.irs.gov/Form3115 for instructions and the latest information.**

OMB No. 1545-2070

Name of filer (name of parent corporation if a consolidated group) (see instructions) **AVISTA CORPORATION**	**Identification number** (see instructions) **91-0462470** Principal business activity code number (see instructions) **221100**
Number, street, and room or suite no. If a P.O. box, see the instructions. **1411 EAST MISSION AVENUE**	Tax year of change begins (MM/DD/YYYY) **1/1/2019** Tax year of change ends (MM/DD/YYYY) **12/31/2019**
City or town, state, and ZIP code **SPOKANE, WA 99202**	Name of contact person (see instructions) **NEVILLE JIANG**
Name of applicant(s) (if different than filer) and identification number(s) (see instructions) **N/A**	Contact person's telephone number **(202) 220-2126**

If the applicant is a member of a consolidated group, check this box . . . . . ▶ [X]

If **Form 2848**, Power of Attorney and Declaration of Representative, is attached (see instructions for when Form 2848 is required), check this box . . . . . ▶ [X]

Check the box to indicate the type of applicant.

- [ ] Individual
- [X] Corporation
- [ ] Controlled foreign corporation (Sec. 957)
- [ ] 10/50 corporation (Sec. 904(d)(2)(E))
- [ ] Qualified personal service corporation (Sec. 448(d)(2))
- [ ] Exempt organization. Enter Code section ▶
- [ ] Cooperative (Sec. 1381)
- [ ] Partnership
- [ ] S corporation
- [ ] Insurance co. (Sec. 816(a))
- [ ] Insurance co. (Sec. 831)
- [ ] Other (specify) ▶

Check the appropriate box to indicate the type of accounting method change being requested.
See instructions.

- [ ] Depreciation or Amortization
- [ ] Financial Products and/or Financial Activities of Financial Institutions
- [X] Other (specify) ▶ **SECTION 263A**

Caution: To be eligible for approval of the requested change in method of accounting, the taxpayer must provide all information that is relevant to the taxpayer or to the taxpayer's requested change in method of accounting. This includes **(1)** all relevant information requested on this Form 3115 (including its instructions), and **(2)** any other relevant information, even if not specifically requested on Form 3115.

The taxpayer must attach all applicable statements requested throughout this form.

Part I Information For Automatic Change Request	Yes	No
1 Enter the applicable designated automatic accounting method change number ("DCN") for the requested automatic change. Enter only one DCN, except as provided for in guidance published by the IRS. If the requested change has no DCN, check "Other," and provide both a description of the change and a citation of the IRS guidance providing the automatic change. See instructions.		
a (1) DCN: **194** (2) DCN: ____ (3) DCN: ____ (4) DCN: ____ (5) DCN: ____ (6) DCN: ____ (7) DCN: ____ (8) DCN: ____ (9) DCN: ____ (10) DCN: ____ (11) DCN: ____ (12) DCN: ____		
b Other [ ] Description ▶		
2 Do any of the eligibility rules restrict the applicant from filing the requested change using the automatic change procedures (see instructions)? If "Yes," attach an explanation.		X
3 Has the filer provided all the information and statements required **(a)** on this form and **(b)** by the List of Automatic Changes under which the applicant is requesting a change? See instructions.	X	
Note: Complete Part II and Part IV of this form, and, Schedules A through E, if applicable.		

Part II Information For All Requests	Yes	No
4 During the tax year of change, did or will the applicant **(a)** cease to engage in the trade or business to which the requested change relates, or (b) terminate its existence? See instructions.		X
5 Is the applicant requesting to change to the principal method in the tax year of change under Regulations section 1.381(c)(4)-1(d)(1) or 1.381(c)(5)-1(d)(1)?		X
If "No," go to line 6a.		
If "Yes," the applicant cannot file a Form 3115 for this change. See instructions.		

Sign Here

Under penalties of perjury, I declare that I have examined this application, including accompanying schedules and statements, and to the best of my knowledge and belief, the application contains all the relevant facts relating to the application, and it is true, correct, and complete. Declaration of preparer (other than applicant) is based on all information of which preparer has any knowledge.

Signature of filer (and spouse, if joint return)	Date	Name and title (print or type)
▶ Daniel Loutzenhiser	10/1/2020	**DANIEL LOUTZENHISER - ASSISTANT TREASURER**

Preparer (other than filer/applicant)

Print/Type preparer's name	Preparer's signature	Date
MATTHEW MCKINNEY	Matthew N. McKinney	10/6/2020
Firm's name ▶ **DELOITTE TAX LLP**		

Part II	Information For All Requests *(continued)*	Yes	No
6a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) under examination (see instructions)?		X
	If "No," go to line 7a.		
b	Is the method of accounting the applicant is requesting to change an issue under consideration (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s))? See instructions.	N/A	
c	Enter the name and telephone number of the examining agent and the tax year(s) under examination. N/A Name ► _____ Telephone number ► _____ Tax year(s) ► _____		
d	Has a copy of this Form 3115 been provided to the examining agent identified on line 6c?	N/A	
7a	Does audit protection apply to the applicant's requested change in the method of accounting? See instructions.	X	
	If "No," attach an explanation.		
b	If "Yes," check the applicable box and attach the required statement. [X] Not under exam [ ] 3-month window [ ] 120 day: Date examination ended ► ..... [ ] Method not before director [X] Negative adjustment [ ] CAP: Date member joined group ► ..... [ ] Audit protection at end of exam [ ] Other		
8a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any federal income tax return(s) before Appeals and/or a federal court?		X
	If "No," go to line 9.		
b	Is the method of accounting the applicant is requesting to change an issue under consideration by Appeals and/or a federal court (for either the applicant or any present or former consolidated group in which the applicant was a member for the tax year(s) the applicant was a member)? See instructions.	N/A	
	If "Yes," attach an explanation.		
c	If "Yes," enter the name of the (check the box) [ ] Appeals officer and/or [ ] counsel for the government, telephone number, and the tax year(s) before Appeals and/or a federal court. N/A Name ► _____ Telephone number ► _____ Tax year(s) ► _____		
d	Has a copy of this Form 3115 been provided to the Appeals officer and/or counsel for the government identified on line 8c?	N/A	
9	If the applicant answered "Yes" to line 6a and/or 8a with respect to any present or former consolidated group, attach a statement that provides each parent corporation's **(a)** name, **(b)** identification number, **(c)** address, and **(d)** tax year(s) during which the applicant was a member that is under examination, before an Appeals office, and/or before a federal court. N/A		
10	If for federal income tax purposes, the applicant is either an entity (including a limited liability company) treated as a partnership or an S corporation, is it requesting a change from a method of accounting that is an issue under consideration in an examination, before Appeals, or before a federal court, with respect to a federal income tax return of a partner, member, or shareholder of that entity?	N/A	
11a	Has the applicant, its predecessor, or a related party requested or made (under either an automatic or non-automatic change procedure) a change in method of accounting within any of the five tax years ending with the tax year of change?	X	
	If "No," go to line 12.		
b	If "Yes," for each trade or business, attach a description of each requested change in method of accounting (including the tax year of change) and state whether the applicant received consent. SEE ATTACHMENT		
c	If any application was withdrawn, not perfected, or denied, or if a Consent Agreement granting a change was not signed and returned to the IRS, or the change was not made or not made in the requested year of change, attach an explanation. N/A		
12	Does the applicant, its predecessor, or a related party currently have pending any request (including any concurrently filed request) for a private letter ruling, change in method of accounting, or technical advice?		X
	If "Yes," for each request attach a statement providing **(a)** the name(s) of the taxpayer, **(b)** identification number(s), **(c)** the type of request (private letter ruling, change in method of accounting, or technical advice), and **(d)** the specific issue(s) in the request(s).		
13	Is the applicant requesting to change its **overall** method of accounting?		X
	If "Yes," complete Schedule A on page 4 of this form.		

Part II	Information For All Requests *(continued)*	Yes	No
14	If the applicant is either **(i) not** changing its overall method of accounting, or **(ii)** is changing its overall method of accounting **and** changing to a special method of accounting for one or more items, attach a detailed and complete description for each of the following (see instructions): **SEE ATTACHMENT**		
a	The item(s) being changed.		
b	The applicant's present method for the item(s) being changed.		
c	The applicant's proposed method for the item(s) being changed.		
d	The applicant's present overall method of accounting (cash, accrual, or hybrid).		
15a	Attach a detailed and complete description of the applicant's trade(s) or business(es). See section 446(d). **SEE ATTACHMENT**		
b	If the applicant has more than one trade or business, as defined in Regulations section 1.446-1(d), describe **(i)** whether each trade or business is accounted for separately; **(ii)** the goods and services provided by each trade or business and any other types of activities engaged in that generate gross income; **(iii)** the overall method of accounting for each trade or business; and **(iv)** which trade or business is requesting to change its accounting method as part of this application or a separate application. **N/A** **Note:** If you are requesting an automatic method change, see the instructions to see if you are required to complete Lines 16a-16c.		
16a	Attach a full explanation of the legal basis supporting the proposed method for the item being changed. Include a detailed and complete description of the facts that explains how the law specifically applies to the applicant's situation and that demonstrates that the applicant is authorized to use the proposed method. **SEE ATTACHMENT**		
b	Include all authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method. **SEE ATTACHMENT**		
c	Include either a discussion of the contrary authorities or a statement that no contrary authority exists. **N/A**		
17	Will the proposed method of accounting be used for the applicant's books and records and financial statements? For insurance companies, see the instructions		X
	If "No," attach an explanation. **SEE ATTACHMENT**		
18	Does the applicant request a conference with the IRS National Office if the IRS National Office proposes an adverse response?	X	
19a	If the applicant is changing to either the overall cash method, an overall accrual method, or is changing its method of accounting for any property subject to section 263A, any long-term contract subject to section 460 (see 19b), or inventories subject to section 474, enter the applicant's gross receipts for the 3 tax years preceding the tax year of change.		

1st preceding year ended: mo. 12 yr. 2018	2nd preceding year ended: mo. 12 yr. 2017	3rd preceding year ended: mo. 12 yr. 2016
$ 1,505,015,471	$ 1,549,703,536	$ 1,501,630,693

b	If the applicant is changing its method of accounting for any long-term contract subject to section 460, in addition to completing 19a, enter the applicant's gross receipts for the 4th tax year preceding the tax year of change: **N/A** 4th preceding year ended: mo. _____ yr. _____ $ _____			

Part III	Information For Non-Automatic Change Request **N/A**	Yes	No
20	Is the applicant's requested change described in any revenue procedure, revenue ruling, notice, regulation, or other published guidance as an automatic change request?		
	If "Yes," attach an explanation describing why the applicant is submitting its request under the non-automatic change procedures.		
21	Attach a copy of all documents related to the proposed change (see instructions).		
22	Attach a statement of the applicant's reasons for the proposed change.		
23	If the applicant is a member of a consolidated group for the year of change, do all other members of the consolidated group use the proposed method of accounting for the item being changed?		
	If "No," attach an explanation.		
24a	Enter the amount of **user fee** attached to this application (see instructions). ► $ _____		
b	If the applicant qualifies for a reduced user fee, attach the required information or certification (see instructions).		

Part IV	Section 481(a) Adjustment	Yes	No
25	Does published guidance require the applicant (or permit the applicant and the applicant is electing) to implement the requested change in method of accounting on a cut-off basis? If "Yes," attach an explanation and do not complete lines 26, 27, and 28 below.		X
26	Enter the section 481(a) adjustment. Indicate whether the adjustment is an increase (+) or a decrease (-) in income. ► $ **-136,736,790** Attach a summary of the computation and an explanation of the methodology used to determine the section 481(a) adjustment. If it is based on more than one component, show the computation for each component. If more than one applicant is applying for the method change on the application, attach a list of the **(a)** name, **(b)** identification number, and **(c)** the amount of the section 481(a) adjustment attributable to each applicant. **SEE ATTACHMENT**		
27	Is the applicant making an election to take the entire amount of the adjustment into account in the tax year of change? If "Yes," check the box for the applicable elective provision used to make the election (see instructions). ☐ $50,000 de minimis election ☐ Eligible acquisition transaction election		X
28	Is any part of the section 481(a) adjustment attributable to transactions between members of an affiliated group, a consolidated group, a controlled group, or other related parties? If "Yes," attach an explanation.		X

Schedule A — Change in Overall Method of Accounting (If Schedule A applies, Part I below must be completed.) **N/A**

Part I Change in Overall Method (see instructions)

1 Check the appropriate boxes below to indicate the applicant's present and proposed methods of accounting.

Present method: ☐ Cash ☐ Accrual ☐ Hybrid (attach description)

Proposed method: ☐ Cash ☐ Accrual ☐ Hybrid (attach description)

2 Enter the following amounts as of the close of the tax year preceding the year of change. If none, state "None." Also, attach a statement providing a breakdown of the amounts entered on lines 2a through 2g.

		Amount
a	Income accrued but not received (such as accounts receivable)	$
b	Income received or reported before it was earned (such as advanced payments). Attach a description of the income and the legal basis for the proposed method	
c	Expenses accrued but not paid (such as accounts payable)	
d	Prepaid expenses previously deducted	
e	Supplies on hand previously deducted and/or not previously reported	
f	Inventory on hand previously deducted and/or not previously reported. Complete Schedule D, Part II	
g	Other amounts (specify). Attach a description of the item and the legal basis for its inclusion in the calculation of the section 481(a) adjustment. ►	
h	**Net section 481(a) adjustment** (Combine lines 2a-2g.) Indicate whether the adjustment is an increase (+) or decrease (-) in income. Also enter the net amount of this section 481(a) adjustment amount on Part IV, line 26	$ -

3 Is the applicant also requesting the recurring item exception under section 461(h)(3)? ☐ Yes ☐ No

4 Attach copies of the profit and loss statement (Schedule F (Form 1040) for farmers) and the balance sheet, if applicable, as of the close of the tax year preceding the year of change. Also attach a statement specifying the accounting method used when preparing the balance sheet. If books of account are not kept, attach a copy of the business schedules submitted with the federal income tax return or other return (such as, tax-exempt organization returns) for that period. If the amounts in Part I, lines 2a through 2g, do not agree with the amounts shown on both the profit and loss statement and the balance sheet, attach a statement explaining the differences.

5 Is the applicant making a change to the overall cash method as a small business taxpayer (see instructions)? ☐ Yes ☐ No

Part II Change to the Cash Method For Non-Automatic Change Request (see instructions)

Applicants requesting a change to the cash method must attach the following information:

1 A description of inventory items (items whose production, purchase, or sale is an income-producing factor) and materials and supplies used in carrying out the business.

2 An explanation as to whether the applicant is required to use the accrual method under any section of the Code or regulations.

Schedule B — Change to the Deferral Method for Advance Payments (see instructions) **N/A**

1 If the applicant is requesting to change to the deferral method for advance payments, as described in the instructions, attach the following information:

a Explain how the advance payments meet the definition of advance payment, as described in the instructions.

b Does the taxpayer use an applicable financial statement as described in the instructions and, if so, identify it.

c Describe the taxpayer's allocation method, if there is more than one performance obligation, as defined in the instructions.

d Describe the taxpayer's legal basis for deferral. See instructions.

e If the applicant is filing under the non-automatic change procedures, see the instructions for the information required.

Schedule C — Changes Within the LIFO Inventory Method (see instructions) **N/A**

Part I General LIFO Information

Complete this section if the requested change involves changes within the LIFO inventory method. Also, attach a copy of all **Forms 970,** Application To Use LIFO Inventory Method, filed to adopt or expand the use of the LIFO method.

1 Attach a description of the applicant's present and proposed LIFO methods and submethods for each of the following items:

a Valuing inventory (for example, unit method or dollar-value method).

b Pooling (for example, by line or type or class of goods, natural business unit, multiple pools, raw material content, simplified dollar-value method, inventory price index computation (IPIC) pools, vehicle-pool method, etc.).

c Pricing dollar-value pools (for example, double-extension, index, link-chain, link-chain index, IPIC method, etc.).

d Determining the current-year cost of goods in the ending inventory (such as, most recent acquisitions, earliest acquisitions during the current year, average cost of current-year acquisitions, rolling-average cost, or other permitted method).

2 If any present method or submethod used by the applicant is not the same as indicated on Form(s) 970 filed to adopt or expand the use of the method, attach an explanation.

3 If the proposed change is not requested for all the LIFO inventory, attach a statement specifying the inventory to which the change is and is not applicable.

4 If the proposed change is not requested for all of the LIFO pools, attach a statement specifying the LIFO pool(s) to which the change is applicable.

5 Attach a statement addressing whether the applicant values any of its LIFO inventory on a method other than cost. For example, if the applicant values some of its LIFO inventory at retail and the remainder at cost, identify which inventory items are valued under each method.

6 If changing to the IPIC method, attach a completed Form 970.

Part II Change in Pooling Inventories

1 If the applicant is proposing to change its pooling method or the number of pools, attach a description of the contents of, and state the base year for, each dollar-value pool the applicant presently uses and proposes to use.

2 If the applicant is proposing to use natural business unit (NBU) pools or requesting to change the number of NBU pools, attach the following information (to the extent not already provided) in sufficient detail to show that each proposed NBU was determined under Regulations sections 1.472-8(b)(1) and (2):

a A description of the types of products produced by the applicant. If possible, attach a brochure.

b A description of the types of processes and raw materials used to produce the products in each proposed pool.

c If all of the products to be included in the proposed NBU pool(s) are not produced at one facility, state the reasons for the separate facilities, the location of each facility, and a description of the products each facility produces.

d A description of the natural business divisions adopted by the taxpayer. State whether separate cost centers are maintained and if separate profit and loss statements are prepared.

e A statement addressing whether the applicant has inventories of items purchased and held for resale that are not further processed by the applicant, including whether such items, if any, will be included in any proposed NBU pool.

f A statement addressing whether all items including raw materials, goods-in-process, and finished goods entering into the entire inventory investment for each proposed NBU pool are presently valued under the LIFO method. Describe any items that are not presently valued under the LIFO method that are to be included in each proposed pool.

g A statement addressing whether, within the proposed NBU pool(s), there are items both sold to unrelated parties and transferred to a different unit of the applicant to be used as a component part of another product prior to final processing.

3 If the applicant is engaged in manufacturing and is proposing to use the multiple pooling method or raw material content pools, attach information to show that each proposed pool will consist of a group of items that are substantially similar. See Regulations section 1.472-8(b)(3).

4 If the applicant is engaged in the wholesaling or retailing of goods and is requesting to change the number of pools used, attach information to show that each of the proposed pools is based on customary business classifications of the applicant's trade or business. See Regulations section 1.472-8(c).

Schedule D — Change in the Treatment of Long-Term Contracts Under Section 460, Inventories, or Other Section 263A Assets (see instructions)

Part I **Change in Reporting Income From Long-Term Contracts** (Also complete Part III on pages 7 and 8.) **N/A**

1 To the extent not already provided, attach a description of the applicant's present and proposed methods for reporting income and expenses from long-term contracts. Also, attach a representative actual contract (without any deletion) for the requested change. If the applicant is a construction contractor, attach a detailed description of its construction activities.

2a Are the applicant's contracts long-term contracts as defined in section 460(f)(1) (see instructions)? ☐ **Yes** ☐ **No**

b If "Yes," do all the contracts qualify for the exception under section 460(e) (see instructions)? ☐ **Yes** ☐ **No**
If line 2b is "No," attach an explanation.

c Is the applicant requesting to use the percentage-of-completion method using cost-to-cost under Regulations section 1.460-4(b)? ☐ **Yes** ☐ **No**

d If line 2c is "Yes," in computing the completion factor of a contract, will the applicant use the simplified cost-to-cost method described in Regulations section 1.460-5(c)? ☐ **Yes** ☐ **No**

e If line 2c is "No," is the applicant requesting to use the exempt-contract percentage-of-completion method under Regulations section 1.460-4(c)(2)? ☐ **Yes** ☐ **No**
If line 2e is "Yes," attach an explanation of what method the applicant will use to determine a contract's completion factor.
If line 2e is "No," attach an explanation of what method the applicant is using and the authority for its use.

3a Does the applicant have long-term manufacturing contracts as defined in section 460(f)(2)? ☐ **Yes** ☐ **No**

b If "Yes," attach a description of the applicant's manufacturing activities, including any required installation of manufactured goods.

4a Does the applicant enter into cost-plus long-term contracts? ☐ **Yes** ☐ **No**

b Does the applicant enter into federal long-term contracts? ☐ **Yes** ☐ **No**

Part II **Change in Valuing Inventories Including Cost Allocation Changes** (Also complete Part III on pages 7 and 8.) **N/A**

1 Attach a description of the inventory goods being changed.

2 Attach a description of the inventory goods (if any) NOT being changed.

3a Is the applicant subject to section 263A? If "No," go to line 4a ☐ **Yes** ☐ **No**

b Is the applicant's present inventory valuation method in compliance with section 263A (see instructions)? If "No," attach a detailed explanation ☐ **Yes** ☐ **No**

4a Check the appropriate boxes in the chart.

	Inventory Method Being Changed		Inventory Method Not Being Changed
Identification methods:	Present method	Proposed method	Present method
Specific identification			
FIFO			
LIFO			
Other (attach explanation)			
Valuation methods:			
Cost			
Cost or market, whichever is lower			
Retail cost			
Retail, lower of cost or market			
Other (attach explanation)			

b Enter the value at the end of the tax year preceding the year of change. $ $

5 If the applicant is changing from the LIFO inventory method to a non-LIFO method, attach the following information (see instructions).

a Copies of Form(s) 970 filed to adopt or expand the use of the method.

b **Only for applicants requesting a non-automatic change.** A statement describing whether the applicant is changing to the method required by Regulations section 1.472-6(a) or (b), or whether the applicant is proposing a different method.

c **Only for applicants requesting an automatic change.** The statement required by section 23.01(5) of Rev. Proc. 2018-31 (or its successor).

Part III **Method of Cost Allocation** (Complete this part if the requested change involves either property subject to section 263A or long-term contracts as described in section 460). See instructions

Section A — Allocation and Capitalization Methods

Attach a description (including sample computations) of the present and proposed method(s) the applicant uses to capitalize direct and indirect costs properly allocable to real or tangible personal property produced and property acquired for resale, or to allocate direct and indirect costs required to be allocated long-term contracts. Include a description of the method(s) used for allocating indirect costs to intermediate cost objectives such as departments or activities prior to the allocation of such costs to long-term contracts, real or tangible personal property produced, and property acquired for resale. The description must include the following:

1 The method of allocating direct and indirect costs (for example, specific identification, burden rate, standard cost, or other reasonable allocation method). **SEE ATTACHMENT**

2 The method of allocating mixed service costs (for example, direct reallocation, step-allocation, simplified service cost using the labor-based allocation ratio, simplified service cost using the production cost allocation ratio, or other reasonable allocation method). **SEE ATTACHMENT**

3 Except for long-term contract accounting methods, the method of capitalizing additional section 263A costs (for example, simplified production with or without the historic absorption ratio election, simplified resale with or without the historic absorption ratio election including permissible variations, the U.S. ratio, or other reasonable allocation method). **SEE ATTACHMENT**

Section B — Direct and Indirect Costs Required to be Allocated

Check the appropriate boxes showing the costs that are or will be fully included, to the extent required, in the cost of real or tangible personal property produced or property acquired for resale under section 263A or allocated to long-term contracts under section 460. Mark "N/A" in a box if those costs are not incurred by the applicant. If a box is not checked, it is assumed that those costs are not fully included to the extent required. Attach an explanation for boxes that are not checked.

		Present method	Proposed method
1	Direct material	X	X
2	Direct labor	X	X
3	Indirect labor	X	X
4	Officers' compensation (not including selling activities)	X	X
5	Pension and other related costs	X	X
6	Employee benefits	X	X
7	Indirect materials and supplies	X	X
8	Purchasing costs	X	X
9	Handling, processing, assembly, and repackaging costs	N/A	N/A
10	Offsite storage and warehousing costs	X	X
11	Depreciation, amortization, and cost recovery allowance for equipment and facilities placed in service and not temporarily idle	X	X
12	Depletion	X	X
13	Rent	X	X
14	Taxes other than state, local, and foreign income taxes	X	X
15	Insurance	X	X
16	Utilities	X	X
17	Maintenance and repairs that relate to a production, resale, or long-term contract activity	X	X
18	Engineering and design costs (not including section 174 research and experimental expenses)	X	X
19	Rework labor, scrap, and spoilage	X	X
20	Tools and equipment	X	X
21	Quality control and inspection	X	X
22	Bidding expenses incurred in the solicitation of contracts awarded to the applicant	X	X
23	Licensing and franchise costs	N/A	N/A
24	Capitalizable service costs (including mixed service costs)	X	X
25	Administrative costs (not including any costs of selling or any return on capital)	X	X
26	Research and experimental expenses attributable to long-term contracts	X	X
27	Interest	X	X
28	Other costs (Attach a list of these costs.)	N/A	N/A

Part III **Method of Cost Allocation** *(continued)* See instructions. **N/A**

Section C — Other Costs Not Required To Be Allocated (Complete Section C only if the applicant is requesting to change its method for these costs.)

		Present method	Proposed method
1	Marketing, selling, advertising, and distribution expenses		
2	Research and experimental expenses not included in Section B, line 26		
3	Bidding expenses not included in Section B, line 22		
4	General and administrative costs not included in Section B		
5	Income taxes		
6	Cost of strikes		
7	Warranty and product liability costs		
8	Section 179 costs		
9	On-site storage		
10	Depreciation, amortization, and cost recovery allowance not included in Section B, line 11		
11	Other costs (Attach a list of these costs.)		

Schedule E — Change in Depreciation or Amortization. See instructions. **N/A**

Applicants requesting approval to change their method of accounting for depreciation or amortization complete this section. Applicants ***must*** provide this information for each item or class of property for which a change is requested.

Note: See the ***Summary of the List of Automatic Accounting Method Changes*** in the instructions for information regarding automatic changes under sections 56, 167, 168, 197, 1400I, 1400L, or former section 168. **Do not** file Form 3115 with respect to certain late elections and election revocations. See instructions.

1 Is depreciation for the property determined under Regulations section 1.167(a)-11 (CLADR)? ☐ **Yes** ☐ **No**
If "Yes," the only changes permitted are under Regulations section 1.167(a)-11(c)(1)(iii).

2 Is any of the depreciation or amortization required to be capitalized under any Code section such as, section 263A? ☐ **Yes** ☐ **No**
If "Yes," enter the applicable section ►

3 Has a depreciation, amortization, expense, or disposition election been made for the property such as the election under sections 168(f)(1), 168(i)(4), 179, 179C, or Regulations section 1.168(i)-8(d)? ☐ **Yes** ☐ **No**
If "Yes," state the election made ►

4a To the extent not already provided, attach a statement describing the property subject to the change. Include in the description the type of property, the year the property was placed in service, and the property's use in the applicant's trade or business or income-producing activity.

b If the property is residential rental property, did the applicant live in the property before renting it? ☐ **Yes** ☐ **No**

c Is the property public utility property? ☐ **Yes** ☐ **No**

5 To the extent not already provided in the applicant's description of its present method, attach a statement explaining how the property is treated under the applicant's present method (for example, depreciable property, inventory property, supplies under Regulations section 1.162-3, nondepreciable section 263(a) property, property deductible as a current expenses, etc.).

6 If the property is not currently treated as depreciable or amortizable property, attach a statement of the facts supporting the proposed change to depreciate or amortize the property.

7 If the property is currently treated and/or will be treated as depreciable or amortizable property, provide the following information for both the present (if applicable) and proposed methods:

a The Code section under which the property is or will be depreciated or amortized (for example, section 168(g)).

b The applicable asset class from Rev. Proc. 87-56, 1987-2 C.B. 674, for each asset depreciated under section 168 (MACRS) or under section 1400L; the applicable asset class from Rev. Proc. 83-35, 1983-1 C.B. 745, for each asset depreciated under former section 168 (ACRS); an explanation why no asset class is identified for each asset for which an asset class has not been identified by the applicant.

c The facts to support the asset class for the proposed method.

d The depreciation or amortization method of the property, including the applicable Code section (for example, 200% declining balance method under section 168(b)(1)).

e The useful life, recovery period, or amortization period of the property.

f The applicable convention of the property.

g Whether the additional first-year special depreciation allowance (for example, as provided by section 168(k), 168(l), 168(m), 168(n), 1400L(b), or 1400N(d)) was or will be claimed for the property. If not, also provide an explanation as to why no special depreciation allowance was or will be claimed.

h Whether the property was or will be in a single asset account, a multiple asset account, or a general asset account.

Part II, Question 11b – Accounting Method Changes in the Past Five Years

Avista Corporation (EIN: 91-0462470) is changing its method of accounting for depreciation effective for the taxable year ended December 31, 2019 under the automatic consent procedures of Rev. Proc. 2019-43.

Avista Corporation (EIN: 91-0462470) is changing its method of accounting for non-incidental materials and supplies under Treas. Reg. § 1.162-3(a) effective for the taxable year ended December 31, 2019 under the automatic consent procedures of Rev. Proc. 2019-43

Avista Corporation (EIN: 91-0462470) is changing its method of accounting for prepaid expenses under Treas. Reg. § 1.263(a)-3 effective for the taxable year ended December 31, 2019 under the automatic consent procedures of Rev. Proc. 2019-43.

Avista Corporation (EIN: 91-0462470) is changing its method of accounting for deducting repairs and maintenance costs and its method of identifying the unit of property, effective for the taxable year ended December 31, 2019 under the automatic consent procedures of Rev. Proc. 2019-43.

Part II, Question 14 – Description of Proposed Change

a. The Applicant is changing its method of accounting for capitalizing mixed service costs under section 263A. The Applicant has not adopted the International Financial Reporting Standards ("IFRS") and the proposed change is not related to the adoption of IFRS.

b. The Applicant presently allocates its mixed service costs to two activities or cost objects: (1) the production of self-constructed assets (including generation, electric transmission and distribution, and gas distribution plant property, where applicable), and (2) the generation, transmission, and distribution of electricity, where applicable. Under its present method, any direct materials allocable to the generation of electricity are capitalized and included in the inventoriable costs of electricity. Any direct material costs allocable to the repair and maintenance of transmission and distribution equipment, maintaining continuous transmission and distribution services, or other transmission and distribution activities are allocated to the transmission and distribution of electricity. The Applicant elects to capitalize certain period costs with respect to transmission and distribution activities, and costs related to such activities are allocated to the electricity transmitted and distributed.

   Under the present method, any physical labor costs allocable to the generation of electricity are capitalized and included in the inventoriable costs of electricity. Any physical labor costs allocable to the repair and maintenance of transmission and distribution equipment, maintaining continuous transmission and distribution services, or other transmission and distribution activities are allocated to the electricity transmitted and distributed.

   Thus, under the present method, the direct material or physical labor costs are traced to the cost objective, such as a function, department, activity, or product on the basis of a cause and effect or other reasonable relationship between the costs and the cost objective. Those costs traced to the cost objective related to the production of self-constructed assets are capitalized and included in the basis of assets produced (either generation, electric transmission, and distribution, or gas distribution property, where applicable). Those costs traced to the cost objectives related to the generation, transmission, or distribution of electricity are capitalized and included in the inventoriable costs of the electricity, where applicable.

Under the present method, indirect costs, including mixed service costs, are allocable to intermediate costs objectives such as departments or activities using cause and effect or reasonable factors and relationships. Indirect costs are subsequently allocated to non-intermediate costs objectives using additional reasonable factors and relationships.

c. The Applicant proposes to capitalize and allocate mixed service costs to self-constructed assets using a method of accounting accepted under the Industry Director Directives issued by the Internal Revenue Service ("IRS") in 2009 and 2014, which is further described below (IDD #5).

d. The Applicant's overall method of accounting is an accrual method.

Part II, Question 15a – Description of Trade or Business

The Applicant is a regulated electric and gas utility company engaged in the generation, transmission, and distribution. The Applicant is also involved in the sale of electricity and the distribution of natural gas. Its principal business activity code is 221100. The Applicant has a single trade or business as described in Treas. Reg. § 1.446-1(d).

Part II, Question 16a-c – Legal Basis for Proposed Change

Treas. Reg. § 1.263A-1(a)(3)(i) provides that taxpayers subject to section 263A must capitalize all direct costs and certain indirect costs properly allocable to –

(A) real property and tangible personal property produced by the taxpayer; and

(B) real property and personal property described in section 1221(1), which is acquired by the taxpayer for resale.

Treas. Reg. § 1.263A-1(a)(3)(ii) provides that taxpayers that produce real property and tangible personal property (producers) must capitalize all the direct costs of producing the property and the property's properly allocable share of indirect costs (described in paragraphs (e)(2)(i) and (3) of this section), regardless of whether the property is sold or used in the taxpayer's trade or business.

Treas. Reg. § 1.263A-2(a)(1) defines produce to include construct, build, install, manufacture, develop, improve, create, raise, and grow.

Treas. Reg. § 1.263A-1(a)(3)(iii) provides that retailers, wholesalers, and other taxpayers that acquire property described in section 1221(1) for resale (resellers) must capitalize the direct costs of acquiring the property and the property's properly allocable share of indirect costs (described in paragraphs (e)(2)(ii) and (3) of this section). See Treas. Reg. § 1.263A-3 for rules relating to resellers. See also section 263A(b)(2)(B), which excepts from section 263A personal property acquired for resale by a small reseller.

Treas. Reg. § 1.263A-1(c) provides the rules related to the general operation of section 263A. Treas. Reg. § 1.263A-1(c)(1) provides that under section 263A, taxpayers must capitalize their direct costs and a properly allocable share of their indirect costs to property produced or property acquired for resale. In order to determine these capitalizable costs, taxpayers must allocate or apportion costs to various activities, including production or resale activities. After section 263A costs are allocated to the appropriate production or resale activities, these costs are generally allocated to the items of property produced or property acquired for resale during the taxable year and capitalized to the items that remain on hand at the end of the taxable year.

Treas. Reg. § 1.263A-1(c)(2)(i) provides that any cost which (but for section 263A and the regulations thereunder) may not be taken into account in computing taxable income for any taxable year is not treated as a cost properly allocable to property produced or acquired for resale under section 263A and the regulations thereunder. Thus, for example, if a business meal deduction is limited by section 274(n) to 80 percent of the cost of the meal, the amount properly allocable to property produced or acquired for resale under section 263A is also limited to 80 percent of the cost of the meal.

Treas. Reg. § 1.263A-1(c)(3) provides that taxpayers subject to section 263A must capitalize all indirect costs properly allocable to property produced. Indirect costs are properly allocable to property produced when the cost directly benefits or is incurred by reason of the performance of the production activity. Additionally, indirect costs may be allocable to both production and resale activities, as well as to other activities not subject to section 263A. Taxpayers must make a reasonable allocation of indirect costs between production, resale, and other activities.

Treas. Reg. § 1.263A-1(d)(1) provides that self-constructed assets are assets produced by a taxpayer for use by the taxpayer in its trade or business. Self-constructed assets are subject to section 263A.

Treas. Reg. § 1.263A-1(e)(3)(ii)(O) includes repairs and maintenance (such as the cost of repairing and maintaining equipment or facilities) in the indirect costs required to be capitalized.

Treas. Reg. § 1.263A-1(e)(4)(i)(A) defines service costs as a type of indirect costs (e.g., general and administrative costs) that can be identified specifically with a service department or function or that directly benefits or are incurred by reason of a service department or function.

Treas. Reg. § 1.263A-1(e)(4)(i)(B) defines service departments as administrative, service, or support departments that incur service costs. The facts and circumstances of the taxpayer's activities and business organization control whether a department is a service department. For example, service departments include personnel, accounting, data processing, security, legal, and other similar departments.

Treas. Reg. § 1.263A-1(e)(4)(ii)(C) provides that mixed service costs are defined as service costs that are partially allocable to production or resale activities (capitalizable mixed service costs) and partially allocable to non-production or non-resale activities (deductible mixed service costs). For example, a personnel department may incur costs to recruit factory workers, the costs of which are allocable to production activities, and it may incur costs to develop wage, salary, and benefit policies, the costs of which are allocable to non-production activities.

Treas. Reg. § 1.263A-1(e)(4)(iv) provides examples of deductible service costs. Specifically, Treas. Reg. § 1.263A-1(e)(4)(iv) provides that costs are incurred in the following departments or function are not generally allocated to production or resale activities:

(A) Departments or functions responsible for overall management of the taxpayer or for setting overall policy for all of the taxpayer's activities or trades or businesses, such as the board of directors (including their immediate staff), and the chief executive, financial, accounting, and legal officers (including their immediate staff) of the taxpayer, provided that no substantial part of the cost of such departments or functions benefit a particular production or resale activity.

(B) Strategic business planning.

(C) General financial accounting

(D) General financial planning (including general budgeting) and financial management (including bank relations and cash management).

(E) Personnel policy (such as establishing and managing personnel policy in general; developing wage, salary, and benefit policies; developing employee training programs unrelated to particular production or resale activities; negotiating with labor unions; and maintaining relations with retired workers).

(F) Quality control policy.

(G) Safety engineering policy.

(H) Insurance or risk management policy (but not including bid or performance bonds or insurance related to activities associated with property produced or property acquired for resale).

(I) Environmental management policy (except to the extent that the costs of any system or procedure benefits a particular production or resale activity.

(J) General economic analysis and forecasting.

(K) Internal audit.

(L) Shareholder, public, and industrial relations.

(M) Tax services.

(N) Marketing, selling, or advertising.

Treas. Reg. § 1.263A-1(f)(3)(i)(A) permits the use of a burden rate method and provides that a burden rate method allocates an appropriate amount of indirect costs to property produced or property acquired for resale during a taxable year using predetermined rates that approximate the actual amount of indirect costs incurred by the taxpayer during the taxable year. Burden rates (such as ratios based on direct costs, hours, or similar items) may be developed by the taxpayer in accordance with acceptable accounting principles and applied in a reasonable manner. A taxpayer may allocate different indirect costs on the basis of different burden rates.

Treas. Reg. § 1.263A-1(f)(4) permits the use of any reasonable method to properly allocate direct and indirect costs among units of property produced or property acquired for resale during the taxable year.

Treas. Reg. § 1.263A-1(g)(4)(ii) provides a de minimis rule. Under this de minimis rule, for the purposes of administrative convenience, if 90 percent or more of a mixed service department's costs are deductible service costs, a taxpayer may elect not to allocate any portion of the service department's cost to property produced or property acquired for resale. For example, if 90 percent of the costs of an electing taxpayer's industrial relations department benefit the taxpayer's overall policy-making activities, the taxpayer is not required to allocate any portion of these costs to a production activity. Under this election, however, if 90 percent or more of a mixed service department's costs are capitalized service costs, a taxpayer must allocate 100 percent of the department's costs to the production or resale activity benefitted. For example, if 90 percent of the costs of an electing taxpayer's accounting department benefit the taxpayer's manufacturing activity, the taxpayer must allocate 100 percent of the costs of the account department to the manufacturing activity. An election under this paragraph (g)(4)(ii) applies to all of a taxpayer's mixed service departments and constitutes the adoption of a (or a change in) method of accounting under section 446.

Treas. Reg. § 1.263A-1(j)(1)(i) provides that a taxpayer subject to section 263A must capitalize an arm's-length charge for any section 263A costs (e.g., costs of materials, labor, or services) incurred by a related person that are properly allocable to the property produced or property acquired for resale by the taxpayer. Both the taxpayer and the related person must account for the transaction as if an arm's-length charge had been incurred by the taxpayer with respect to its property produced or property acquired for resale. For purposes of this paragraph (j)(1)(i), a taxpayer is considered related to another person if the taxpayer and such person are described in section 482. Further, for purposes of this paragraph (j)(1)(i), arm's-length

charge means the arm's-length charge (or other appropriate charge where permitted and applicable) under the principles of section 482. Any correlative adjustments necessary because of the arm's-length charge requirement of this paragraph (j)(1)(i) shall be determined under the principles of section 482.

Beginning in 2000, a number of electric and gas utilities changed to the simplified service cost method ("SSCM") of accounting in order to determine the amount of mixed service costs allocable to self-constructed assets. See, generally, Treas. Reg. § 1.263A-1(h). In 2005, the IRS eliminated the availability of the SSCM to determine the amount of mixed service costs allocable to the self-constructed assets proposed by electric and gas companies. Rev. Rul. 2005-53, 205-35 I.R.C. 425; T.D. 9217, 2005-37 I.R.B. 498. Thus, beginning in 2005, electric and gas utilities used a variety of facts and circumstances methodologies to determine the amount of mixed service costs allocable to self-constructed assets. Some companies employed methods specifically set forth in the section 263A regulations, other companies employed self-developed methods, and yet other companies followed the financial accounting method for tax purposes.

Until September 2009, there was significant controversy regarding what methods were available to utilities to determine the amount of mixed service costs allocable to self-constructed assets. On September 15, 2009, the IRS' Large and Mid-sized Business Division ("LMSB") (subsequently, the Large Business and International Division ("LB&I")) issued Industry Director Directive Mixed Service Costs #5 (LMSB-04-0809-033) ("IDD #5"). In IDD #5, LMSB set forth an example of a mixed service costs method considered relatively less significant to compliance priorities ("the IDD Method"). Since the issuance of IDD #5, LB&I has allowed a number of companies to use the IDD Method and has encouraged other utilities to accept exam-imposed changes to the IDD Method.

In October 2014, LB&I issued a supplemental Industry Director Directive to examiners regarding the IDD Method, Allocating Mixed Service Costs Under I.R.C. Section 263A to Certain Self-Constructed Property of Electric and Natural Gas Utilities (LB&I-LB7I-04-0814-007). The 2014 guidance applies to electric utilities, natural gas utilities, and combined electric and natural gas utilities and provides guidance in determining whether a taxpayer's method for allocating mixed service costs to certain self-constructed tangible personal property is appropriate and should not be challenged. The Applicant's proposed method of accounting is consistent with the IDD Method described in the above cited LB&I directives.

Part II, Question 17 – Book-Tax Conformity

The Applicant will not use the proposed method of account for its books and records or its financial statements because the proposed method does not conform to Generally Accepted Accounting Principles ("GAAP").

Part IV, Question 26 – Section 481(a) Adjustment

The net negative I.R.C. § 481(a) adjustment is ($136,736,790) and constitutes a decrease to taxable income. The net I.R.C. § 481(a) adjustment is equal to the difference as of the beginning of the year of change between the adjusted basis of self-constructed assets as revalued using the Applicant's proposed method and the adjusted basis of the property as originally valued using the Applicant's former method. The Applicant is using a three-year averaging convention similar to the three-year revaluation method in Treas. Reg. § 1.263A-7(d)(2) to determine the amount of mixed service costs capitalizable from 2000 through 2015.

Schedule D, Part III, Section A

The method of allocating (1) direct and indirect costs.

The Applicant's present method of allocating direct material and physical labor costs to the production of self-constructed assets (including generation, electric transmission and distribution, and gas distribution plant assets, where applicable), or generation, transmission, and distribution of electricity (where applicable) is a method where direct material or physical labor costs are traced to a cost objective, such as a function, department, activity, or product on the basis of a cause and effect or other reasonable relationship between the costs and the cost objective. The Applicant does not propose to change these methods.

The Applicant's present method of allocating indirect costs, other than mixed service costs, is a method where indirect costs are traced to a cost objective such as function, department, activity or product, on the basis of a cause and effect or other reasonable relationship between the costs and the cost objective. Those costs traced to the cost objectives related to the production of self-constructed assets (including generation, electric transmission and distribution, and gas distribution plant assets, where applicable) will be capitalized and those costs traced to the cost objectives related to the generation, electric transmission and distribution activities will be included in the inventoriable costs of electricity, where applicable. The Applicant does not propose to change these methods.

The method of (2) allocating mixed service costs and (3) capitalizing additional I.R.C. § 263A costs.

The Applicant's present method of allocating mixed service costs uses reasonable factors and relationships to allocate the total costs of all mixed service departments to other departments or activities and from those departments or activities ultimately to particular activities. The Applicant proposes to allocate mixed service costs to self-constructed assets (including generation, electric transmission and distribution, and gas distribution plant assets, where applicable) using the method of accounting provided for, and being applied by, LB&I pursuant to the IDD method. Under this method, the Applicant will identify all mixed service costs as: Companywide Mixed Service Costs ("CW MSCs"), Electric Transmission & Distribution, Engineering Mixed Service Costs, Electric Transmission & Distribution Mixed Service Costs (non-engineering), Gas Mixed Service Costs, Fleet Mixed Service Costs, and Stores Mixed Service Costs.

CW MSCs will be allocated to the Generation, Electric Transmission & Distribution, and Gas Distribution Functions using the following Headcount ratios:

Generation Employee Headcount / Total Headcount	x CW MSCs	=	CW MSCs allocable to Generation
T&D Employee Headcount / Total Headcount	x CW MSCs	=	CW MSCs allocable to Electric T&D
Gas Employee Headcount / Total Headcount	x CW MSCs	=	CW MSCs allocable to Gas Distribution

Then the CW MSCs allocable to generation will be added to any Generation Mixed Service costs ("GMSCs"). The sum of these amounts is the Total Generation Mixed Service Costs ("TGMSCs"). The capitalizable portion of the Total GMSCs will be determined under the following ratio:

Generation Production Headcount / Total Generation Headcount	x TGMSCs	=	Capitalizable GMSCs

The CW MSCs allocable to electric transmission and distribution will be added to the non-Engineering Mixed Service costs. The sum of these amounts is the Total Electric Transmission and Distribution Mixed Service Costs ("Total TDMSCs (non-eng)"). The capitalizable portion of the Total TDMCs (non-eng) will be determined under the following ratio:

T&D Production Headcount Total T&D Headcount	x Total TDMSCs (non-eng)	=	Capitalizable TDMCs (non-eng)

The capitalizable portion of Electric Transmission and Distribution Engineering Mixed Service costs ("Total TDMSCs (eng)") will be determined under the following ratio:

T&D Production Headcount Total T&D Headcount (less metering & customer serv)	x Total TDMSCs (eng)	=	Capitalizable TDMSCs (eng)

The CW MSCs allocable to Gas Distribution will be added to the Gas Distribution Mixed Service Costs. The sum of these amounts is the Total Gas Distribution Mixed Service Costs (Total Gas MSCs). The capitalizable portion of the Total Gas Distribution MSCs will be determined under the following ratio:

Gas Production Headcount Total Gas Headcount (less customer collection headcount)	x Total Gas MSCs	=	Capitalizable Gas MSCs

The denominator of this ratio is reduced by the number of the employees engaged in meter reading and customer collections because engineering does not provide support to these functions.

The capitalizable portion of Fleet Mixed Service Costs and Stores Mixed Service Costs will be determined under headcount ratios in which the numerator includes the production employees benefitting from these departments and the denominator includes the total employees benefitting by these departments. The Applicant will use a single ratio for Fleet and single ratio for Stores.

The sum of the Capitalizable Generation Mixed Service Costs, the Capitalizable Engineering Electric Transmission and Distribution Mixed Service Costs, the Capitalizable Electric Transmission and Distribution Mixed Service Costs (non-engineering), the Capitalizable Gas Distribution Mixed Service Costs, the Capitalizable Fleet Mixed Service Costs, and the Capitalizable Stores Mixed Service Costs is the Total Capitalizable Mixed Service Costs. The amount of the Total Capitalizable Mixed Service Costs allocable and capitalizable to self-constructed assets is determined under the following production ratio:

$$\frac{\text{Total 263A SCA Costs}}{\text{Total 263A SCA Costs} + \text{263A Costs of Electricity/Gas Sold} - (\text{Costs of Purchased Power/Gas} * 50\%) - \text{MSCs Capitalized} - \text{Interest Capitalized to SCA}}$$

Under this ratio the Total 263A SCA Costs are the total tax basis costs of constructing assets (less interest and mixed service costs). The Costs of Produced Power/Gas are the costs, other than the acquisition cost of purchased power or purchased gas and other than mixed service costs, required to be capitalized under section 263A. The Costs of Purchased Power/Gas are the acquisition costs of purchased electricity and gas.

Request for Facsimile Transmission Pursuant to Section 9.04(3) of Rev. Proc. 2020-1

The Applicant hereby requests that a facsimile transmission of any document related to this Form 3115 be sent to the Applicant as follows:

Applicant	**Fax Number**
Daniel Loutzenhiser	(509) 777-5642

Applicant's Representatives	**Fax Number**
Neville Jiang	(855) 411-8531
Matt McKinney	(704) 285-6654
Jon Ryan	(855) 320-9645