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*Attorneys for SUEZ Water Idaho Inc.*

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IDAHO PUBLIC  
UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE  
APPLICATION OF SUEZ WATER  
IDAHO INC. FOR AUTHORITY TO  
INCREASE ITS RATES AND  
CHARGES FOR WATER SERVICE IN  
THE STATE OF IDAHO

Case No. SUZ-W-20-02

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

DIRECT TESTIMONY OF MATTHEW KAHN

SEPTEMBER 2020

1 **Q. Please state your name and business address.**

2 A. I am Matthew H. Kahn. My business address is 461 From Road, Paramus,  
3 NJ 07652.

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

5 A. I am the Tax Manager, Utility Division for SUEZ Water Management &  
6 Services Inc. ("SUEZ Water M&S").

7 **Q. What are your job responsibilities?**

8 A. I am primarily responsible for the management of income taxes for SUEZ  
9 Water Inc.'s ("SUEZ") regulated utilities.

10 **Q. Please outline your educational and professional qualifications.**

11 A. I received a Bachelor of Accountancy degree from Bentley University in  
12 2004. Subsequently, I received a Masters of Taxation degree from Bentley  
13 University in 2010. I joined SUEZ Water M&S as Tax Manager in July of  
14 2019. Previous to that, I was employed by Con Edison, an electric, natural  
15 gas and steam utility operating in the northeast, as Tax Manager,  
16 overseeing income taxes and depreciation.

17 **Q. Have you previously testified before the Idaho Public Utilities  
18 Commission ("Commission" or "IPUC")?**

19 A. No. However, I have previously testified before other state commissions on  
20 various regulatory issues, including New York and New Jersey.

21 **Q. What is the purpose of your testimony in this proceeding?**

1 A. The purpose of my testimony is to present ratemaking considerations  
2 resulting from the Tax Cuts and Jobs Act ("TCJA") as well as to sponsor  
3 Exhibit 12.

4 **Q. Have you prepared or had prepared under your direction any exhibits**  
5 **to your testimony?**

6 A. Yes, I am sponsoring Exhibit 12, Schedule 1 which provides support for the  
7 balance of the TCJA regulatory liability at the test year ended June 30,  
8 2020. Exhibit No. 10, Schedule 1 provides the amortization of the TCJA  
9 regulatory liability for the test year ended June 30, 2020.

10 **Q. Please describe the TCJA and its effects on the Company's books and**  
11 **records.**

12 A. On December 22, 2017, the President signed into law the TCJA which  
13 substantially modifies the Internal Revenue Code and has a direct impact  
14 on Suez Water Idaho ("SWID" or "Company") and other regulated utilities.  
15 The TCJA provision having the greatest direct impact is the reduction of the  
16 corporate income tax rate from 35% to 21%. This change reduces both  
17 current and deferred Federal Income Tax Expense for SWID and reduces  
18 the amount of Accumulated Deferred Income Tax ("ADIT") required to be  
19 recognized on the Company's balance sheet. Generally Accepted  
20 Accounting Principles ("GAAP") required that companies reflect the effects  
21 of the change in ADIT in the 2017 financial statements resulting from the  
22 change in the FIT rate from 35% to 21%. Also, because SWID is rate  
23 regulated and subject to the jurisdiction of the Commission, that change in

1 the total balance of ADIT, including gross-up, was reflected as a regulatory  
2 liability on the Company's balance sheet as of December 31, 2017 in  
3 response to the IPUC Generic Tax Order No. 33965, Case No. GNR-U-18-  
4 01 (Jan. 16, 2018). This regulatory liability amount is also commonly  
5 referred to as excess accumulated deferred income taxes ("EADIT"), and  
6 was subsequently addressed in Order No. 34074 by the Commission, Case  
7 No. GNR-U-18-01 (May 31, 2018).

8 **Q. Has the IDPSC addressed the treatment of the EADIT regulatory**  
9 **liability?**

10 A. Yes. In Order No. 34074, the Commission reduced the Company's rates to  
11 reflect a decrease in SWID's rates by \$2.7 million to reflect the reduction in  
12 the FIT rate, as well as an order to file an update to its deferred income tax  
13 records in order to work with Staff to determine the amount and manner in  
14 which to return to customers the remaining benefits from the TCJA, as  
15 agreed by Commission Staff, and the Company. The Company's base rates  
16 were changed effective June 1, 2018 as ordered.

17 **Q. What were the results of the Company's updates to its initial filing of**  
18 **its EADIT balances in response to Order No. 33965?**

19 A. The Company has performed a review of its deferred tax balances as of  
20 December 31, 2017, and has finalized its 2017 tax returns subsequent to  
21 the initial Order. The result of the updates to the original filing reduced the  
22 overall regulatory liability by approx. \$20,000 as a result of return to  
23 provision (RTP) and tax basis balance sheet (TBBS) adjustments.

1 **Q. What are RTP and TBBS adjustments and why are they necessary?**

2 A. For GAAP accounting purposes, the Company records an income tax  
3 provision based upon its books and records. It is normally several months  
4 before the income tax return is completed and filed. For example, the  
5 Company's 2018 federal income tax return was filed on October 15, 2019.  
6 In order to reflect the correct balance, any differences between the tax  
7 return filing and the income tax provision filing are accounted for (or trued-  
8 up) by adjusting the balances to match the tax return.

9 Separately, TBBS adjustments reflect a review of overall timing  
10 differences which support the accumulated deferred income tax balances  
11 for any specific item giving rise to differences between financial accounting  
12 and the accounting for income tax purposes. As those timing differences  
13 reverse, the accumulated deferred tax obligations will reverse and become  
14 currently payable to the Company.

15 **Q. What is the balance of the EADIT regulatory liability balance after  
16 this adjustment?**

17 A. The balance is \$5,980,752, representing a reduction to the original balance  
18 provided in response to Order 33965 of \$19,962. This amount is reflected  
19 in my Exhibit No. 12, Schedule 1.

20 **Q. Does this indicate a change in the amortization of the amount of the  
21 EADIT regulatory liability balance?**

22 A. Yes. However, there are two other considerations that must be addressed.  
23 The first is an adjustment to the protected and unprotected EADIT balances.

1 The second is to address the Company's required use of the Average Rate  
2 Assumption Method (ARAM) for returning the protected portion of the  
3 EADIT balance.

4 **Q. Please describe the Company's understanding and definition of**  
5 **"protected" and "unprotected" EADIT.**

6 A. The amortization period for the amount of the regulatory liability which  
7 arose from temporary differences between book and tax methods and  
8 lives that are considered "protected" and, per the Internal Revenue Code  
9 Section 168(f)9 normalization rules may be amortized no faster than over  
10 the period in which ADIT would have otherwise reversed over the  
11 remaining book lives of its assets. The Average Rate Assumption Method  
12 ("ARAM") of amortization must be utilized for as much of the regulatory  
13 liability as possible if the requisite data is available to the utility. ARAM  
14 calculates a specific amount by year rather than a period of amortization  
15 and if amortized faster, could result in a normalization violation which  
16 would prohibit the Company from utilizing accelerated depreciation for  
17 income tax purposes. The results of the Company's ARAM calculations  
18 from 2021 through 2023 are as follows:

<b>ARAM</b>	
2021	\$227,000
2022	\$233,000
2023	\$251,000

1 The amortization period for the amount of the regulatory liability which arose  
2 from amounts not considered normalized are “unprotected” and may be  
3 amortized by the utility over a period different from the protected amount.

4 **Q. What amount is the Company utilizing for the ARAM amortization in**  
5 **this case?**

6 A. As shown above, for 2021 the maximum amount of ARAM amortization that  
7 can be recognized in 2021 is \$227,000. For 2022 the current calculation  
8 indicates that the maximum amount that can be amortized is about  
9 \$233,000. However, the Company believes that, because the ARAM  
10 amount is updated annually and could change either up or down because  
11 of the retirement of fixed assets, an amortization amount of \$203,000 for  
12 this case is prudent in order to allow for potential changes in the ARAM  
13 amount for 2021 and following once the recalculation is performed. As this  
14 case will likely set rates for more than one year, if the amount of the  
15 amortization of the protected portion of the EADIT set in this case is greater  
16 than the ARAM amount in a future period, the Company would need to file  
17 for a change in tariff rates to reduce the amortization to the amount allowed  
18 in that future period. The ARAM amount is a maximum amount or “speed  
19 limit” if you will therefore, an amortization amount of \$203,000 for the  
20 protected EADIT is included in Exhibit No. 10, Schedule 1.

21 **Q Please describe the adjustment to the protected and unprotected**  
22 **EADIT balances.**

1 A. In reviewing the Company's balances, the Company believes it is  
2 reasonable to believe that amounts included in the EADIT balances related  
3 to Tangible Property Regulations are not protected under the normalization  
4 rules. There is support for this view in the form of a private letter ruling  
5 202017015 released 4/24/2020 attached as Exhibit 12, Schedule 2 to this  
6 testimony. This change increases the amount of unprotected EADIT to be  
7 returned to customers by approximately \$1.8 million which the Company is  
8 proposing to amortize, along with its EADIT related to cost of removal and  
9 tank painting, over a 10 year period in this case as included in Exhibit No.  
10 10, Schedule 1.

11 **Q. Does this conclude your testimony at this time?**

12 A. Yes.



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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION  
OF SUEZ WATER IDAHO INC. FOR  
AUTHORITY TO INCREASE ITS RATES  
AND CHARGES FOR WATER SERVICE  
IN THE STATE OF IDAHO

Case No. SUZ-W-20-02

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

EXHIBIT 12 TO ACCOMPANY THE  
DIRECT TESTIMONY OF MATTHEW KAHN

SUEZ Water Idaho Inc.  
 Accumulated Deferred Income Tax and Excess Deferred Income Tax Regulatory Liability Balances  
 As of December 31, 2017

Line No.	Account	Description (b)	ADIT Balance at 12/31/2017 [c]	Adjustments [3]	Adjusted Balance at 12/31/2017	Rate Base Related ADIT [d]	Protected @ 21% FIT Rate [e]	Unprotected @ 21% FIT Rate [f]
1	19010	Def. Federal Inc Taxes- Other	\$36,638	(\$85,697)	(49,059)			\$0
2	28203	Def. FIT-MACRS	10,041,452	(\$1,835,147)	8,206,305	\$8,206,305	\$8,206,305	
3	28203	Def. FIT-MACRS - Unprotected		\$1,829,346	1,829,346	1,829,346		1,829,346
4	28206	Def. FIT- OCI Pension/PBOP		\$2,195,178	0	0	(382,157)	0
5	28211	Def. FIT Benefit on DSIT	(382,157)	\$0	(382,157)	(382,157)		
6	28300	Def. FIT-Other	323,379	(\$40)	323,339			
7	28301	Def. FIT-Tank Painting	232,709	\$0	232,709	232,709		232,709
8	28302	Def. FIT-Rate Expenses	11,568	\$0	11,568			
9	28303	Def. FIT-Deferred Charges	(97,443)	\$308,905	211,462			
10	28304	Def. FIT-Relocation Expense	11,429	\$0	11,429			
11	28305	Def. FIT-M_S Fees	(458,444)	(\$434,802)	(893,246)			
12	28306	Def. FIT-Pensions	649,113	(\$6,560)	642,553			
13	28307	Def. FIT-PEBOP	(754,400)	\$754,400	0	0		0
14	28308	Def. FIT-Cost of Removal	916,880	(\$30,933)	885,947	885,947		885,947
15	28310	Def. FIT-Uncollectibles	(108,154)	\$0	(108,154)			
16	28311	Def. FIT-Injuries and Damages	(310,942)	\$0	(310,942)			
17	28312	Def. FIT - AFUDC Equity	468,114	\$39	468,153	468,153	468,153	
18	28313	Def. FIT - AFUDC Equity GU [1]	426,875	(\$426,875)	0			
19	28314	Def. FIT - AFUDC Equity GU-TRF [1]	642,034	(\$642,034)	0			
20								
21		Total Deferred Tax before TCJA impact [2]	9,453,473	1,625,781	11,079,254	11,240,303	8,292,301	2,948,002
22								
23	28405	Def FIT - New Federal Tax Rate	(3,752,294)	(645,309)	(4,397,602)	(4,496,121)	(3,316,920)	(1,179,201)
24	28406	Def FIT-New Federal TaxRate GU	(1,350,837)	(232,313)	(1,583,150)	(1,618,101)	(1,194,101)	(424,516)
25		283 Deferred Income taxes & ITC	<u>\$4,350,342</u>	<u>\$748,159</u>	<u>\$5,098,502</u>	<u>\$5,125,565</u>	<u>\$12,073,580</u>	<u>\$4,292,288</u>
26	25316	Regulatory Liab-Tax New Federal Rate	\$5,103,131	\$877,622	\$5,980,752	\$6,114,738	\$4,511,022	\$1,603,717

[1] Change in balance is offset by the change in balance of the associated regulatory asset.

[2] Sum of Lines 1 through 19.

[3] Adjustments include Tax Return to Provision, TBBS adjustments, OCI and AFUDC regulatory asset, and reclassification of unprotected MACRS deferred taxes.

	2018	2017
State Income Tax Rate	6.925%	7.400%
Federal Income Tax Rate	21.000%	35.000%
Federal Rate net of State Benefit	19.546%	32.410%
Composite Rate	26.471%	39.810%

Difference in Federal Rate Net of State Benefit  
 Change in Federal Rate Net of State Benefit including State Rate Change

12.864%  
 39.692%

**Internal Revenue Service**

Number: **202017015**  
Release Date: 4/24/2020  
Index Number: 168.24-01

Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact: \_\_\_\_\_, ID No. \_\_\_\_\_  
Telephone Number: \_\_\_\_\_

In Re:

Refer Reply To:  
CC:PSI:B06  
PLR-117557-19  
Date:  
January 23, 2020

LEGEND:

Taxpayer =  
  
Parent =  
  
State A =  
  
Commission =  
  
Order =  
  
Date 1 =  
  
Date 2 =  
  
Date 3 =  
  
Date 4 =  
  
Date 5 =  
  
Date 6 =  
  
Date 7 =  
  
Year 1 =  
  
Year 2 =

- a =
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- c =
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- e =
- f =
- g =

Dear :

This letter responds to a request for a private letter ruling dated July 26, 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 in connection with a Consent Agreement related to a Form 3115, *Application for Change in Accounting Method*, filed that was approved for the Year 1 tax year. 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 Parent. Taxpayer uses an accrual method of accounting as its overall method of accounting.

Parent is a water and wastewater utility company. Taxpayer is the regulated water/wastewater utility subsidiary affiliate that operates in State A. Prices charged by Taxpayer are set by the Commission in the manner described in this letter.

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 and infrastructure surcharge proceedings.

For general rate case 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 a recovery of operating expenses, including depreciation expense, property tax expense, salary expense, and income tax expense. In setting the allowed return for the utilities that it regulates, Commission treats accumulated deferred income

tax liabilities (ADIT) as zero-cost capital in the computation of a weighted-average costs of capital to be applied to a rate base computation that is not reduced by ADIT.

The issues presented in this ruling request are a result of the following two separate but related proceedings (collectively referred to as "Rate Proceeding" throughout the ruling request):

- Investigation into the impacts of the Tax Cuts and Jobs Act of 2017 ("TJCA" or "Act") and possible rate implications initiated by the Commission on Date 1 with respect to all jurisdictional rate-regulated, investor-owned utilities.
- Petition to increase its rates and charges for water utility service initiated by Taxpayer on Date 2.

On Date 1, the Commission initiated an investigation to allow the Commission to consider the impacts and resulting benefits from the Act and how any resulting benefit should be realized by customers.

In general, subject to future guidance expected to be issued by the Service related to the excess accumulated deferred income taxes (EADIT) normalization rules, Taxpayer and the other parties are generally in agreement as to which specific timing differences and associated ADIT and EADIT are and are not subject to normalization requirements. The only disputes that exist are related to the Taxpayer's timing difference with respect to its tax-only repair and maintenance deductions. The disagreement with regard to repair-related EADIT is due to differing interpretations of 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 methods of accounting for costs to repair and maintain tangible property and for dispositions of certain tangible depreciable property described in this letter.

On Date 4, parties to the Rate Proceeding entered into a settlement agreement. On Date 5, the Commission approved the settlement ("Order"). Rates became effective on Date 6 and were based on a test period ending Date 7. The settlement agreement resolved both the general rate case and the TCJA case, subject to clarification of the uncertainty described in this letter concerning the scope of the deferred tax normalization rules. Because of the uncertainty related to the Consent Agreement described in this letter, a condition of the Order permits Taxpayer to submit this ruling request.

Specifically, the Order provides, in part, that the parties have agreed in the pending rate case that, for purposes of certain rates, Taxpayer will use the estimate of EADIT which produces a result that is approximately the same as an estimate using ARAM for the entirety of Taxpayer's EADIT. The parties further agreed that Taxpayer will seek a private letter ruling from the Service requesting a determination whether the Commission has the discretion to order an amortization of EADIT related to Taxpayer's

tax deductions for repairs that is faster than the average rate assumption method (ARAM). The parties agreed the ruling request is not an opportunity for advocacy for one outcome or another and that the ruling request will be drafted using neutral and unbiased language.

As noted, Taxpayer and its affiliates changed their tax methods of accounting for costs to repair and maintain tangible property and for dispositions of certain tangible depreciable property in a prior tax year. The year of change was Year 1, and Taxpayer's net deductible § 481(a) adjustment was approximately \$a. The Consent Agreement granting permission for the tax accounting method changes states that this amount represents a netting of the net negative § 481(a) adjustment for maintenance and repairs with the net positive § 481(a) adjustment for dispositions. The Consent Agreement described the netting as a one-time exception allowed to Taxpayer for the year of change based on its particular situation. The net deductible § 481(a) adjustment for the repair-related change in tax method of accounting was \$b and the net taxable § 481(a) adjustment for the disposition-related change in tax method of accounting was \$c.

The Consent Agreement provides nine conditions that Taxpayer must satisfy including the following condition, at issue, related to the normalization rules:

- 9) 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(l)(3)(A):
- (A) A normalization method of accounting (within the meaning of § 168(i)(9), former § 168(e)(3)(B), or former § 167(l)(3)(G), as applicable) must be used for such public utility property;
  - (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 such public utility property; and
  - (C) Within 30 calendar days of filing the federal income tax return for the year of change or of receiving this letter ruling, whichever is later, the taxpayer must provide a copy of its Form 3115 (and any additional information submitted to the Service in connection with such Form 3115) to any regulatory body having jurisdiction over such public utility property.

The parties to the Rate Proceeding generally agree that the EADIT related to the repairs method change and ongoing repairs deductions are not subject to the normalization requirements under the applicable statute and regulations. Notwithstanding that agreement, however, Taxpayer is party to the Consent Agreement that has very specific terms and conditions, including the condition nine above. Taxpayer and other parties disagree whether the condition nine applies to Taxpayer's request to change its method of accounting for repairs pursuant to § 162, or to Taxpayer's request to change its units of property for determining dispositions under

§ 168. Further, depending upon how this issue is answered, there is an additional question of whether the EADIT that existed immediately prior to the beginning of the year of change for the changes in tax method of accounting and resulted from depreciation method and life differences remains subject to the deferred tax normalization rules after implementation of the new tax method of accounting and recognition of the § 481(a) adjustment.

Since the beginning of Year 1, the year of change for the new tax method of accounting for repairs, and through the end of Year 2, Taxpayer has deducted approximately \$d of costs as repairs under § 162. These amounts were capitalized and are depreciable for regulatory and financial reporting purposes. No income tax depreciation was claimed on any of the \$d of costs claimed as repairs under § 162 of the Code. The gross tax-only repair amounts are originating timing differences. During these years, approximately \$e of depreciation was reported for regulatory and financial reporting purposes with respect to these costs. The book-only depreciation related to the tax-only repairs has been the mechanism that Taxpayer was using prior to the TCJA to reverse this timing difference. Similarly, the deductible repair-related component of the § 481(a) adjustment of \$f constituted an originating timing difference and the book-only depreciation related to this amount has been the mechanism to reverse this timing difference. Through the end of Year 2, approximately \$g of book depreciation was reported for regulatory and financial reporting purposes with respect to the repair-related component of the § 481(a) adjustment.

The deferred tax normalization issues for which Taxpayer requests rulings are:

- 1) Whether net EADIT attributable to expenditures deducted as repairs for tax purposes under § 162 after the beginning of the year of change through the end of Year 2 pursuant to Taxpayer's Consent Agreement and capitalized and depreciated for regulatory and financial reporting purposes is subject to the normalization rules of § 168(i)(9)(A).
- 2) Whether net EADIT attributable to expenditures deducted as repairs as the deductible (negative) component of the net § 481(a) adjustment recognized in Year 1 related to the change in tax method of accounting for repairs (net of tax depreciation deducted under the former tax method of accounting) pursuant to Taxpayer's Consent Agreement is subject to the normalization rules of § 168(i)(9)(A).
- 3) Whether EADIT associated with depreciation method and life differences arising prior to the beginning of the year of change with respect to property that was public utility property under the former method of accounting and for which its remaining tax basis was deducted as part of the repair component of the net § 481(a) adjustment pursuant to Taxpayer's Consent Agreement remains subject to the normalization rules of § 168(i)(9)(A).

## RULINGS REQUESTED

(1)

The net EADIT resulting from expenditures (1) related to an item of property includible in rate base and recoverable as regulatory depreciation expense and (2) deducted as repairs under § 162 to public utility property within the meaning of § 168(i)(10) 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) and is not required to be treated as subject to a normalization method of accounting pursuant to the Consent Agreement. As such return of net EADIT related to such timing difference faster than ARAM would not be a violation of the EADIT normalization rules and would not be a violation of the Consent Agreement.

or

The net EADIT resulting from expenditures (1) related to an item of property includible in rate base and recoverable as regulatory depreciation expense and (2) deducted as repairs under § 162 to public utility property within the meaning of § 168(i)(10) 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), but is required to be treated as subject to a normalization method of accounting pursuant to the Consent Agreement. As such, return of net EADIT related to such timing difference faster than ARAM would not be a violation of the EADIT normalization rules, but would be a violation of the Consent Agreement.

(2)

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 methods of accounting subject to Taxpayer's Consent Agreement, the net EADIT resulting from the repair-related component of the § 481(a) adjustment is not subject to the normalization method of accounting within the meaning of § 168(i)(9), and is not required to be treated as subject to a normalization method of accounting pursuant to the Consent Agreement. As such, return of net EADIT related to such timing difference faster than ARAM would not be a violation of the EADIT normalization rules and would not be a violation of the Consent Agreement.

or

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 methods of accounting subject to Taxpayer's Consent Agreement, the net EADIT resulting from the repair-related component of the § 481(a) adjustment is subject to the normalization method of accounting within the meaning of § 168(i)(9), or is required to be treated as subject to a normalization method of accounting pursuant to the Consent Agreement.



As such, return of EADIT related to such timing difference faster than ARAM would be a violation of the EADIT normalization rules and would be a violation of the Consent Agreement.

(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 methods of accounting subject to Taxpayer's Consent Agreement, the net depreciation-related ADIT that existed prior to the changes in tax methods of accounting for repairs and dispositions remains subject to the normalization method of accounting within the meaning of § 168(i)(9) even after implementation of the new tax method of accounting. As such, return of any net EADIT related to such timing difference faster than ARAM would be a violation of the EADIT normalization rules. Under the circumstances described above, return of any EADIT related to such timing difference faster than ARAM would not be a violation of the Consent Agreement.

or

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 methods of accounting subject to Taxpayer's Consent Agreement, the net depreciation-related ADIT that existed prior to the changes in tax methods of accounting for repairs and dispositions is not subject to the normalization method of accounting within the meaning of § 168(i)(9) even after implementation of the new tax method of accounting and is not required to be normalized pursuant to the Consent Agreement. As such, return of any net EADIT related to such timing difference faster than ARAM would not be a violation of the EADIT normalization rules and would not be a violation of the Consent Agreement.

or

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 methods of accounting subject to Taxpayer's Consent Agreement, the net depreciation-related ADIT that existed prior to the changes in tax methods of accounting for repairs and dispositions is not subject to the normalization method of accounting within the meaning of § 168(i)(9) after implementation of the new tax method of accounting. However, pursuant to the Consent Agreement, a normalization method of accounting is required. As such, return of any net EADIT related to such timing difference faster than ARAM would not be a violation of the EADIT normalization rules, but would be a violation of the Consent Agreement.

## LAW AND ANALYSIS

Section 1.167(l)-1(a)(1) 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 method of 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).

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 account 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.

Taxpayer's ruling request # 3 pertains to whether EADIT associated with depreciation method and life differences arising prior to the beginning of the year of change (Year 1) with respect to property that was public utility property under the former method of accounting and for which its remaining tax basis was deducted as part of the repair component of the net § 481(a) adjustment pursuant to Taxpayer's Consent

Agreement remains subject to the normalization rules of § 168(i)(9)(A). Beginning with the year of change, Taxpayer's Consent Agreement granted Taxpayer permission to change its method of accounting for costs to repair and maintain tangible property from capitalizing and depreciating these costs to deducting these costs under § 162.

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 (Year 1), 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, 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, in regard to ruling request 2, 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).

Lastly, 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, in regard to ruling request 1, net EADIT attributable to expenditures deducted as repairs for tax purposes under § 162 after the beginning of the year of change through the end of Year 2 pursuant to Taxpayer's Consent Agreement and capitalized and depreciated for regulatory and financial reporting purposes is not subject to the normalization rules of § 168(i)(9)(A)

Based on the foregoing, we conclude that:

For ruling request # 1, the net EADIT resulting from expenditures (1) related to an item of property includible in rate base and recoverable as regulatory depreciation expense and (2) deducted as repairs under § 162 to public utility property within the meaning of § 168(i)(10) 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) and is not required to be treated as subject to a normalization method of accounting pursuant to the Consent Agreement. As such return of net EADIT related to such timing difference faster than ARAM would not be a violation of the EADIT normalization rules and would not be a violation of the Consent Agreement.

For ruling request # 2, 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 methods of accounting subject to Taxpayer's Consent Agreement, the net EADIT resulting from the repair-related component of the § 481(a) adjustment is not subject to the normalization method of accounting within the meaning of § 168(i)(9), and is not required to be treated as subject to a normalization method of accounting pursuant to the Consent Agreement. As such, return of net EADIT related to such timing difference faster than ARAM would not be a violation of the EADIT normalization rules and would not be a violation of the Consent Agreement.

For ruling request # 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 methods of accounting subject to Taxpayer's Consent Agreement, the net depreciation-related ADIT that existed prior to the changes in tax methods of accounting for repairs and dispositions is not subject to the normalization method of accounting within the meaning of § 168(i)(9) even after implementation of the new tax method of accounting and is not required to be normalized pursuant to the Consent Agreement. As such, return of any net EADIT related to such timing difference faster than ARAM would not be a violation of the EADIT normalization rules and would not be a violation of the Consent Agreement.

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. Specifically, we are not ruling on 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.

To note, the EADIT at issue in this request does not address the excess tax reserves resulting from the corporate tax rate decrease in the Tax Cuts and Jobs Act (TCJA), Pub. L. 115-97 (131 Stat 2054). The EADIT at issue is only that as described in this letter ruling.

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: