

Request for Comments on Necessary Clarifications to Normalization Requirements for Excess Tax Reserves Resulting from the Corporate Tax Rate Decrease

Notice 2019-33

SECTION 1. PURPOSE

This notice announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to issue guidance under § 168 of the Internal Revenue Code to clarify the normalization requirements for 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). This notice requests comments about ratemaking issues that have arisen or are anticipated due to the corporate tax rate decrease and the requirements of section 13001(d) of the TCJA.

SECTION 2. BACKGROUND

In general, normalization is a system of accounting used by regulated public utilities to reconcile the tax treatment of accelerated depreciation of public utility assets with their regulatory treatment. Under normalization, a utility receives the tax benefit of accelerated depreciation in the early years of an asset's regulatory useful life and passes that benefit through to ratepayers ratably over the regulatory useful life of the asset in the form of reduced rates.

Section 168 of the Code generally allows taxpayers to compute their depreciation deduction for federal income tax purposes under the accelerated cost recovery system. Section 168(f)(2) provides that § 168 does not apply to any public utility property, as

defined in § 168(i)(10), if the taxpayer does not use a normalization method of accounting. Section 168(i)(9) describes what constitutes a “normalization method of accounting.”

In order to use a normalization method of accounting, § 168(i)(9)(A)(i) requires a taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account (regulated tax expense), to use a method of depreciation for property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for establishing its cost of service for ratemaking 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), then the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Former § 167(l) generally contained the requirements discussed above regarding permitting public utilities to use accelerated methods for calculating depreciation only if they used a “normalization method of accounting.” The requirements for establishing and adjusting the reserve required by § 168(i)(9)(A)(ii) are contained in § 1.167(l)-1 of the Income Tax Regulations.

Section 1.168(i)-3, finalized in 2008 (2008 regulations), provides rules on the treatment of excess deferred income tax reserve upon disposition of deregulated public utility property.

Section 1.168(i)-3(a)(1) generally provides rules for the application of section

203(e) of the Tax Reform Act of 1986 (1986 Act), Public Law 99–514 (100 Stat. 2146), to a taxpayer with respect to public utility property (within the meaning of § 168(i)(10)) that ceases, whether by disposition, deregulation, or otherwise, to be public utility property with respect to the taxpayer and that is not described in § 1.168(i)-3(a)(2) (deregulated public utility property).

Section 1.168(i)-3(b) provides that if a public utility property of a taxpayer becomes deregulated public utility property to which this section applies, the reduction in the taxpayer's excess tax reserve permitted under section 203(e) of the 1986 Act is equal to the amount by which the reserve could be reduced under that provision if all such property had remained public utility property of the taxpayer and the taxpayer had continued use of its normalization method of accounting with respect to such property.

SECTION 3: TAX CUTS AND JOBS ACT

The TCJA, enacted on December 22, 2017, generally reduced the corporate tax rate under § 11 of the Code from 35 percent to 21 percent for taxable years beginning after December 31, 2017. Section 13001(a).

Section 13001(d) of the TCJA includes accompanying but uncodified normalization requirements. Section 13001(d)(1) provides that a normalization method of accounting shall not be treated as being used with respect to any public utility property for purposes of §§ 167 or 168 if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method (ARAM).

Section 13001(d)(2) provides an alternative method for certain taxpayers. If, as of the first day of the taxable year that includes the date of enactment of the TCJA, the taxpayer was required by a regulatory agency to compute depreciation for public utility property on the basis of an average life or composite rate method, and the taxpayer's books and underlying records did not contain the vintage account data necessary to apply ARAM, the taxpayer will be treated as using a normalization method of accounting if, with respect to such jurisdiction, the taxpayer uses the alternative method for public utility property that is subject to the regulatory authority of that jurisdiction.

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

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

the period in question, by the amount of the timing differences which reverse during such period.

Section 13001(d)(3)(C) defines the “alternative method” as the method in which the taxpayer computes the excess tax reserve on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation for regulatory purposes, and reduces the excess tax reserve ratably over the remaining regulatory life of the property.

Section 13001(d)(4) provides that, for any taxable year ending after the date of the enactment of the TCJA, if the taxpayer does not use a normalization method of accounting for the corporate rate reductions provided in the amendments made by section 13001, then the taxpayer's tax for the taxable year shall be increased by the amount by which it reduces its excess tax reserve more rapidly than permitted under a normalization method of accounting, and such taxpayer shall not be treated as using a normalization method of accounting for purposes of § 168(f)(2) and (i)(9)(C).

The Joint Explanatory Text of the Committee of Conference, H. Rept. 115-466 (Conference Report), adds more clarification about the normalization rules in section 13001(d) of the TCJA. The Conference Report states that the excess tax reserve is the reserve for deferred taxes as of the day before the corporate rate reduction takes effect over what the reserve for deferred taxes would be if the corporate rate reduction had been in effect for all prior periods. Conference Report, at 343. If an excess tax reserve is reduced more rapidly or to a greater extent than such reserve would be reduced

under ARAM¹, the taxpayer will not be treated as using a normalization method with respect to the corporate rate reduction. If the taxpayer does not use a normalization method of accounting for the corporate rate reduction, the taxpayer's tax for the taxable year shall be increased by the amount by which it reduces its excess tax reserve more rapidly than permitted under a normalization method of accounting and the taxpayer will not be treated as using a normalization method of accounting for purposes of § 168(f)(2) and (i)(9)(C).

The Conference Report also explains in greater detail the application of ARAM. According to the Conference Report, ARAM reduces the excess tax reserve over the remaining regulatory lives of the property that gave rise to the reserve for deferred taxes during the years in which the deferred tax reserve related to such property is reversing. Id. Under this method, the excess tax reserve is reduced as the timing differences reverse over the remaining life of the asset. The reversal of timing differences generally occurs when the amount of the tax depreciation taken with respect to an asset is less than the amount of the regulatory depreciation taken with respect to the asset. To ensure that the deferred tax reserve, including the excess tax reserve, is reduced to zero at the end of the regulatory life of the asset that generated the reserve, the amount of the timing difference which reverses during a taxable year is multiplied by the ratio of (1) the aggregate deferred taxes as of the beginning of the period in question to (2) the aggregate timing differences for the property as of the beginning of the period in question.

¹ Section 13001(d)(2) provides that certain taxpayers may use the alternative method to calculate the reduction of their excess tax reserve and such taxpayers will be treated as using a normalization method of accounting.

SECTION 4: THE TAX REFORM ACT OF 1986 AND REV. PROC. 88-12

For taxable years beginning on or after July 1, 1987, section 601 of the 1986 Act reduced the maximum federal income tax applicable for corporations from 46 percent to 34 percent.

Similar to section 13001(d) of the TCJA, section 203(e) of the 1986 Act provided rules for reducing the excess tax reserve resulting both from that reduction and from the smaller reduction in rates for tax years starting before and ending after July 1, 1987. Section 203(e)(2)(B) of the 1986 Act defined ARAM as the method under which the excess tax reserve is reduced over the remaining lives of the property (as used in a public utility's regulated books of account) that gave rise to the reserve for deferred taxes. Some taxpayers, however, did not necessarily have adequate data to apply ARAM because they were required by regulatory agencies to depreciate property for regulatory purposes using a weighted average life or composite rate, and such a method focuses on the entire plant and does not account for property by vintage accounts. The 1986 Act, however, did not provide taxpayers an alternative method to ARAM.

Rev. Proc. 88-12, 1988-1 C.B. 637, provides an alternative method sometimes referred to as the Reverse South Georgia Method (RSGM). Under section 4.01 of Rev. Proc. 88-12, a taxpayer uses the RSGM if it computed the excess tax reserve on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation for regulatory purposes, and reduced the excess tax reserve ratably over the remaining regulatory life of the

property. Section 5.01 of Rev. Proc. 88-12 provides generally that for eligible taxpayers the RSGM satisfied the requirements of section 203(e) of the 1986 Act.

In summary, section 13001(d)(1) of the TCJA provides ARAM as the regular method in the same manner as that provided in section 203(e)(2)(B) of the 1986 Act. Section 13001(d)(2) of the TCJA provides an alternative method that, while not specifically referred to as the RSGM, is nevertheless the same as the RSGM as originally provided in Rev. Proc. 88-12.

SECTION 5. REQUEST FOR COMMENTS

The Treasury Department and the IRS request comments on issues that should be addressed in proposed guidance to clarify the normalization requirements for excess tax reserves resulting from the corporate tax rate decrease in the TCJA and the requirements of section 13001(d) of the TCJA as well as comments regarding what form of guidance would be most useful. Specifically, the Treasury Department and the IRS request comments that address the following:

- (1) Situations where taxpayers may have vintage account data in their underlying books and records in some form but such data is not necessarily useful for ARAM without significant additional analysis and expense. More specifically, comments on whether some sort of “reasonable” test should be provided, under which the use of the alternative method by a taxpayer is permissible if the cost to the taxpayer of assembling the data contained in the underlying books and records in a way necessary to apply ARAM exceeds a reasonable amount, based on a percentage of rate base or some other factor.

- (2) Other fact patterns where taxpayers may use the alternative method instead of ARAM including but not limited to comments on when the RSGM is a taxpayer's current normalization method of accounting for excess deferred taxes, regardless of the availability of vintage or class information for the accumulated deferred income taxes (ADIT) that had been accrued after the 1986 Act.
- (3) Net operating loss (NOL) issues including but not limited to comments on the significance of a depreciation-related NOL carryforward in the context of excess deferred taxes, and comments on whether a depreciation-related NOL as of December 31, 2017, must be analyzed for normalization purposes based on the underlying loss year.
- (4) By their terms, the 2008 regulations apply only to section 203(e) of the 1986 Act, but the Treasury Department and the IRS believe it may be appropriate to extend their application to section 13001(d) of the TCJA. Comments on the ongoing relevance of the 2008 regulations including but not limited to comments on the treatment of book-only retirements and tax dispositions in regard to significant transactions (such as sales of power plants) versus day-to-day (ordinary or not significant) transactions as well as comments on transactions not addressed in the 2008 regulations such as like-kind exchanges or other dispositions of public utility property.
- (5) The implementation of interim rates to reflect the TCJA's decrease in the corporate tax rate including but not limited to comments about the meaning of the phrase "reduces the excess tax reserve more rapidly or to

a greater extent than such reserve would be reduced under ARAM.”

- (6) Whether the proration formula required by § 1.167(l)-1(h)(6)(ii) must be applied to excess deferred tax activity related to reversals (refunds) of excess deferred taxes if the company uses a future test period or a part-historical, part-future test period.
- (7) Methodology of reversing protected (by the normalization rules) versus unprotected ADIT after the 2017 rate changes.

SECTION 6. ADDRESS TO SEND COMMENTS

Any comments must be received by July 29, 2019. Taxpayers may submit comments electronically via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and Notice 2019-33). Alternatively, taxpayers may submit hard copy submissions to:

CC:PA:LPD:PR (Notice 2019-33), Room 5203, Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C., 20044

Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

CC:PA:LPD:PR (Notice 2019-33), Courier's Desk, Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224
Attn: CC:PA:LPD:PR

All comments received will be available for public inspection on www.regulations.gov.

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Martha M. Garcia of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Ms. Garcia at (202) 317-6853 (not a toll-free call).