Joint Committee on Taxation
October 10, 1989
JCX-63-89

H.R. 2493 (UTILITY CUSTOMER REFUND ACT OF 1989)[1]

Scheduled for Markup
by the
House Committee on Ways and Means
on October 11, 1989

Present Law

Normalization in general

In order for public utility property to be eligible for the more favorable depreciation allowances available under the accelerated cost recovery system ("ACRS"), the tax benefits of ACRS must be normalized in setting rates charged by utilities to customers and in reflecting operating results in regulated books of account.[2] The tax benefits of ACRS are considered to be normalized only if certain requirements are satisfied.

First, the tax expense of the public utility for ratemaking purposes must be computed by using the same depreciation method that is used in determining depreciation for ratemaking purposes and by using a useful life that is no shorter than the useful life used in determining depreciation for ratemaking purposes (which generally results in depreciation being determined over a relatively long useful life and using the straight-line method).

Second, the difference between the actual tax expense computed using ACRS and the tax expense determined for ratemaking purposes must be reflected in a deferred tax reserve.

Third, in determining the rate of return of a public utility, the public utility commission may not exclude from the rate base an amount that exceeds the addition to the deferred tax reserve for the period used in determining the tax expense for ratemaking purposes.

Public utility property is defined as property used

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[1] For further discussion of this bill and related issues, see JCX-55-89, September 29, 1989.

[2] Similar rules are provided for certain public utility property placed in service prior to 1981 (the first year that ACRS was applicable).

predominantly in the trade or business of the furnishing or sale of: (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, (3) telephone services, (4) other communications services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. 701), or (5) transportation of gas or steam by pipeline, if the rates for such furnishing or sale are subject to certain regulation.

Normalization of excess deferred tax reserve

The Tax Reform Act of 1986 (1986 Act) reduced the maximum corporate income tax rate from 46 to 34 percent, effective on July 1, 1987. In addition, the 1986 Act requires public utilities to normalize the portion of their deferred tax reserve that is attributable to use of accelerated depreciation for Federal income tax purposes and that is defined as "excess" due to the 1986 Act reduction in corporate income tax rates (sec. 203(e) of the 1986 Act). If the excess deferred tax reserve is not normalized as required by the 1986 Act, then, for Federal income tax purposes, public utility property must be depreciated using the depreciation method, useful life determination, averaging convention, and salvage value limitation that is used for purposes of setting rates and reflecting operating results in the regulated books of account of the public utility.

The excess deferred tax reserve equals the excess of: (1) the balance of the deferred tax reserve as it existed immediately before the enactment of the 1986 Act, over (2) what the balance of such deferred tax reserve would have been if the amount of the reserve was determined by assuming that the corporate income tax rate reductions provided by the 1986 Act were in effect for all prior periods.

The excess deferred tax reserve is normalized under the 1986 Act only if, in setting utility rates and reflecting operating results in the regulated books of account, the reserve is not reduced more rapidly than such reserve would be reduced under the "average rate assumption method." The average rate assumption method is a method that reduces the excess deferred tax reserve over the remaining regulatory life of the property that gave rise to the reserve for deferred taxes.

Under the average rate assumption method, the excess deferred tax reserve is reduced as the depreciation timing differences (i.e., the differences between tax depreciation and regulatory depreciation with respect to each item of property or class of property in the case of vintage accounts) reverse over the life of the property. The reversal of depreciation timing differences generally occurs when the amount of the tax depreciation with respect to an item of property is less than the amount of depreciation as determined using regulatory depreciation methods with respect to such property. The excess deferred tax reserve is multiplied by a ratio that is designed to assure that the reserve is reduced to zero at the end of the regulatory life of the property that generated the reserve.

Description of H.R. 2493 (Utility Customer Refund Act of 1989)

Explanation of Provisions

H.R. 2493 would provide that, in order for a public utility to be considered to be using a normalization method of accounting, adjusted excess tax reserves could be reduced no faster than the more rapid of whichever of the following methods would result in the more rapid reduction of such reserve: (1) ratable monthly amortization over a 36-month period, or (2) the average rate assumption method of present law. For purposes of the bill, the adjusted excess tax reserve means the balance of the excess deferred tax reserve (as defined in sec. 203(e) of the 1986 Act) as of January 1, 1991.

Although not a part of H.R. 2493, the sponsor of the bill, Mr. Matsui, intends that public utility commissions, in making the determination on the treatment of excess deferred taxes, should consider the following factors:

1) The near-term and short-term benefits to residential, business, and industrial ratepayers and wholesale customers;

2) Rate stability;

3) The ability of utilities to borrow capital;

4) Needed utility system improvements;

5) Unfunded nuclear power plant decommissioning costs;

6) Unfunded acid rain abatement costs; and

7) Existing deficiencies in deferred income tax reserves.

Effective Date

The provisions of the bill would be effective for periods beginning on or after January 1, 1991.