

NOL – NOL Impairment Cost Benefit Analysis

PNM Exhibit MFH-6

Is contained in the following 3 pages

Public Service Company of New Mexico
NMPRC Case No. 16-00276-UT
Cost-Benefit Analysis of Bonus Depreciation
Test Period Ended 12/31/2018

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<u>Bonus Depreciation Deductions</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
AMORTIZATION 3 YR	155,339	157,125	3,396,769	1,684,597	861,647	991,350	1,064,968	293,133	
MACRS 12	261,567	73,151	170,727	523,828	203,511	157,934	522,032	(69,645)	
MACRS 15	11,739,165	4,710,075	18,930,037	22,810,843	12,464,915	11,032,339	29,690,288	52,487,002	71,665,770
MACRS 20	24,066,102	21,546,627	31,167,181	43,176,119	35,298,685	27,280,450	23,251,497	29,370,443	38,901,612
MACRS 4	29,648	36,553	296		42,357	94	11,056	12,148	
MACRS 5	(8,412,635)	12,896,678	14,259,634	105,842,297	14,257,705	33,025,161	34,037,767	44,218,883	24,010,088
MACRS 7	1,064,288	4,278,732	1,487,380	3,283,478	3,903,685	5,442,076	3,603,150	3,333,461	
MACRS 9	(72)	13,560	6,961	220	4,914	1,537			
SL 20 Year	53,350								
Total Bonus Depreciation Deductions	28,956,752	43,712,501	69,418,985	177,321,382	67,037,419	77,930,941	92,180,758	129,645,425	134,577,470
Tax Rate	39.59%	39.59%	39.59%	39.59%	39.59%	39.59%	39.42%	39.19%	39.02%
Bonus Depreciation ADIT	11,463,978	17,305,779	27,482,976	70,201,535	26,540,114	30,852,860	36,337,655	50,808,042	52,512,129

<u>Forgone MACRS Depreciation Deductions</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
2008	9,980								
2009	517,356	4,275,302							
2010	1,268,323	7,254,428	5,757,310						
2011	1,610,002	5,134,343	10,128,980	24,710,895					
2012	1,339,372	3,752,485	7,848,135	40,580,470	5,523,679				
2013	1,635,438	3,434,490	5,793,628	26,344,415	9,578,528	9,132,619			
2014	1,985,828	2,563,357	4,882,057	17,354,406	7,159,500	15,267,459	9,891,810		
2015	1,850,173	1,719,852	3,793,738	16,574,832	5,437,968	10,404,255	16,693,877	13,093,419	
2016	1,789,442	1,449,732	2,786,328	10,130,783	4,890,616	7,198,420	11,667,020	22,167,020	9,844,117
2017	1,788,029	1,246,444	2,605,770	3,787,905	3,826,939	6,626,101	8,319,330	15,614,589	17,299,784
2018	1,789,447	1,245,103	2,522,627	3,483,109	2,824,814	4,528,491	7,670,478	11,410,211	13,334,821
Total Foregone MACRS Depreciation Deductions	15,583,389	32,075,536	46,118,573	142,966,816	39,242,044	53,157,345	54,242,515	62,285,239	40,478,721

	<u>Projected</u>				<u>Test Period</u>
<u>Bonus Depreciation Deductions</u>	<u>2017</u>	<u>2018</u>	<u>Total</u>	<u>Proration</u>	<u>ADIT</u>
AMORTIZATION 3 YR			8,604,928		
MACRS 12			1,843,105		
MACRS 15	77,162,231	65,292	111,377,662	(53,442)	
MACRS 20	40,497,586	23,182,152	205,786,661	(18,974,591)	
MACRS 4			132,152		
MACRS 5	35,792,305	3,483,826	205,906,607	(2,851,512)	
MACRS 7			26,396,250		
MACRS 9			27,120		
SL 20 Year			53,350		
Total Bonus Depreciation Deductions	153,452,122	26,731,270	560,127,835	(21,879,544)	
Tax Rate	38.79%	38.62%		38.62%	
Bonus Depreciation ADIT	59,524,078	10,323,616	393,352,763	(8,449,880)	384,902,882
			393,352,763		

	<u>2017</u>	<u>2018</u>	<u>Total</u>	<u>ADIT</u>	<u>Proration</u>	<u>Test Period</u> <u>ADIT</u>
<u>Foregone MACRS Depreciation Deductions</u>						
2008			9,980	3,951		3,951
2009			4,792,657	1,897,413		1,897,413
2010			14,280,062	5,653,476		5,653,476
2011			41,584,219	16,463,192		16,463,192
2012			59,044,141	23,375,576		23,375,576
2013			55,919,119	22,138,379		22,138,379
2014			59,104,418	23,298,962		23,298,962
2015			56,474,695	22,132,433		22,132,433
2016			39,912,342	15,573,796		15,573,796
2017	12,535,232		28,200,519	10,938,981		10,938,981
2018	21,707,470	1,569,361	24,064,068	9,293,543	(7,606,765)	1,686,778
Total Foregone MACRS Depreciation Deductions	34,242,702	1,569,361	383,386,218	150,769,701	(7,606,765)	143,162,936

	<u>Test Period</u>
ADIT Benefit from Bonus Depreciation	241,739,946
Less: NOL ADIT Asset resulting from Bonus Depreciation	(69,528,340)
Net Reduction in Rate Base due to Bonus Depreciation	172,211,606
Reduction in Return on Rate Base Due to Bonus Depreciation	12,933,092
Change in Taxable Income	12,933,092
Change in Federal Income Tax	4,655,012
Change in State Income Tax	784,702
Remove State NOL Impairment	(1,959,132)
Change in Revenue Tax	83,476
Net Benefit to Customers	16,497,149

Public Service Company of New Mexico
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Regular MACRS Depreciation

	1	2	3	4	5	6	7	8	9	10	11	12
YEAR	20 yr MACRS	15 yr MACRS	12 yr MACRS	10 yr MACRS	9 yr MACRS	7 yr MACRS	5 yr MACRS	4 yr MACRS	3yr MACRS	20yr straight line	3yr straight line	
1	3.7500%	5.0000%	6.2500%	10.0000%	8.3330%	14.2900%	20.0000%	25.0000%	33.3300%	2.5000%	16.6700%	
2	7.2190%	9.5000%	11.7190%	18.0000%	15.2780%	24.4900%	32.0000%	37.5000%	44.4500%	5.0000%	33.3300%	
3	6.6770%	8.5500%	10.2540%	14.4000%	12.7320%	17.4900%	19.2000%	18.7500%	14.8100%	5.0000%	33.3300%	
4	6.1770%	7.7000%	8.9720%	11.5200%	10.6090%	12.4900%	11.5200%	12.5000%	7.4100%	5.0000%	16.6700%	
5	5.7130%	6.9300%	7.8500%	9.2200%	9.6450%	8.9300%	11.5200%	6.2500%		5.0000%		
6	5.2850%	6.2300%	7.3280%	7.3700%	9.6450%	8.9200%	5.7600%			5.0000%		
7	4.8880%	5.9000%	7.3270%	6.5500%	9.6450%	8.9300%				5.0000%		
8	4.5220%	5.9000%	7.3270%	6.5500%	9.6450%	4.4600%				5.0000%		
9	4.4620%	5.9100%	7.3280%	6.5600%	9.6450%					5.0000%		
10	4.4610%	5.9000%	7.3270%	6.5500%	4.8230%					5.0000%		
11	4.4620%	5.9100%	7.3270%	3.2800%						5.0000%		
12	4.4610%	5.9000%	7.3270%							5.0000%		
13	4.4620%	5.9100%	3.6640%							5.0000%		
14	4.4610%	5.9000%								5.0000%		
15	4.4620%	5.9100%								5.0000%		
16	4.4610%	2.9500%								5.0000%		
17	4.4620%									5.0000%		
18	4.4610%									5.0000%		
19	4.4620%									5.0000%		
20	4.4610%									5.0000%		
21	2.2310%									2.5000%		
TOTAL	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%	100.0000%

IRS Private Letter Ruling 8818040

PNM Exhibit MFH-7

Is contained in the following 3 pages

PLR 8818040, 1988 WL 571175 (IRS PLR)

Internal Revenue Service (I.R.S.)

Private Letter Ruling

Issue: May 6, 1988
February 9, 1988

Section 168 -- (Repealed-1976 Act) Amortization of Emergency Facilities 168.00-00 (Repealed-1976 Act) Amortization of Emergency Facilities

168.08-00

168.08-02

CC:C:2:6-TR-31-06461-87

LEGEND:

Commission = * * *

Dear * * *

This is in response to your request for a letter ruling dated November 23, 1987, submitted on your behalf by your authorized representative. You have asked us to rule whether, to the extent that the use of the Accelerated Cost Recovery System (ACRS) in 1986 and prior years in determining the taxpayer's depreciation expense for Federal income tax purposes contributed to a net operating loss (NOL) carryover from 1985 and 1986 to 1987, the taxpayer's use of the Federal statutory income tax rate in effect in 1987 for purposes of computing the deferred tax expense in its regulated books of account for the year 1987 will be consistent with the normalization requirements under sections 167 and 168 of the Internal Revenue Code and the Income Tax Regulations promulgated thereunder.

The taxpayer is incorporated under the laws of the State of * * *, has its principal executive offices at * * *, and files its returns with the Internal Revenue Service in * * *. The taxpayer files its returns using a calendar year. The Internal Revenue Service (IRS) district office in * * * has examination jurisdiction over the taxpayer's return.

The taxpayer is a regulated public utility transmitting and distributing electric power. It has been represented under penalty of perjury that the Commission has been apprised of the taxpayer's ruling request and has no objection to the issuance of a ruling on the request.

As a public utility, the taxpayer is required to use the normalization method of accounting as a condition to its use of accelerated depreciation methods, including ACRS, for Federal income tax purposes. Accordingly, the taxpayer records deferred tax expense for financial statement and regulatory purposes pursuant to the provisions of sections 167 and 168 of the Code and the regulations thereunder. Hereinafter, the accelerated depreciation that the taxpayer is required to normalize is referred to as ACRS.

The amount of Federal income tax expense that the taxpayer recorded for financial statement purposes for 1986 and prior years was greater than the Federal income taxes actually paid. The additional recorded Federal income taxes (deferred taxes) resulted, in part, from a significant amount of property placed in service in 1985, which increased the

depreciation deduction for Federal income tax purposes. However, the taxpayer did not realize the entire tax benefit from the ACRS depreciation claimed in 1985 and 1986 because the depreciation resulted in a NOL carryover to 1987. Therefore, in order to reflect the tax benefit of the NOL carryover to 1987, the taxpayer reduced its deferred Federal income tax expense and liability for 1985 and 1986 for financial reporting purposes. The net effect of this accounting in 1985 and 1986 was to record no deferred taxes applicable to the amount of ACRS depreciation that produced no current tax savings but rather caused or increased taxpayer's NOL carryover to 1987. The taxpayer only recorded deferred taxes applicable to ACRS when and to the extent that the use of ACRS produced an actual tax deferral.

The taxpayer will have taxable income in 1987 in excess of the NOL carryover from 1986. Consequently, the ACRS depreciation that was claimed in 1985 and 1986, but did not then produce a tax benefit, will produce a benefit in 1987 when the NOL is utilized. Accordingly, for 1987 the taxpayer proposes to record the deferred Federal income tax expense resulting from the use of the NOL carryover from 1986 at the rate of 39.95%, the effective income tax rate for 1987. This rate is lower than the 46 percent rate in effect during 1986 and the prior years when the ACRS depreciation was originally deducted on the taxpayer's Federal income tax return.

Section 168(f)(2) of the Code generally requires the use of the normalization method of accounting with respect to regulated public utility property in order for the public utility to be allowed to use ACRS depreciation for Federal income tax purposes.

Section 168(i)(9)(A) of the Code sets forth the normalization accounting requirements. This section provides that the taxpayer must, in computing its tax expense for purposes of establishing its cost of service for rate making purposes and reflecting operating results in its regulated books of account, use a method of depreciation with respect to such 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 such purposes. In addition, if the amount allowable as a deduction under this section with respect to such property differs from the amount that would be allowable as a deduction under section 167 (determined without regard to section 167(1)) using the method (including the period, first and last year convention, and salvage value) used to compute regulated tax expense under clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 1.167(1)-1(h)(1)(i) of the regulations provides that a taxpayer uses a normalization method of regulated accounting if the taxpayer makes adjustments to a reserve to reflect the total amount of the deferral of Federal income tax liability resulting from the use with respect to all of its public utility property of such different methods of depreciation.

Section 1.167(1)-1(h)(1)(iii) of the regulations provides that, except as provided in this subparagraph, the amount of Federal income tax liability deferred as a result of the use of different methods of depreciation under subdivision (i) of this subparagraph is the excess (computed without regard to credits) of the amount the tax liability would have been had a subsection (1) method been used over the amount of the actual tax liability. Such amount shall be taken into account for the taxable year in which such different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a section (1) method for purposes of determining the taxpayer's reasonable allowance under section 167(a) results in a net operating loss carryover (as determined under section 172) 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 section 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.

Under the regulations, the amount of deferred taxes is computed using a 'with and without' methodology. (That is, deferred taxes equal the excess of taxes due without ACRS over the taxes due with ACRS). Where taxes computed with ACRS produce a NOL carryover, the amount and time of the deferral is left to the discretion of the Internal Revenue Service.

The taxpayer maintains that where the computation utilizing ACRS results in a NOL, the deferral is appropriately made at the time the taxpayer realizes an actual tax benefit from the use of ACRS. The taxpayer will realize the benefit of the NOL attributable to the accelerated depreciation in 1987. Therefore, the taxpayer should record the deferred taxes in 1987. We conclude that this approach is consistent with the normalization requirements under sections 167 and 168 of the Code.

With respect to the amount of the deferral, the Federal statutory income tax rates in effect in 1987 for calendar year taxpayers, pursuant to the Tax Reform Act of 1986, can reasonably be combined to result in an effective rate of 39.95 percent. See section 3 of Rev. Proc. 88-12, 1988-8 I.R.B. _____. This is lower than the 46 percent rate in effect when the NOL was incurred. Because the deferred taxes are being recorded in 1987, it is appropriate to utilize the effective tax rate for that year. We note that this approach is consistent with generally accepted accounting principles as set forth in APB Opinion No. 11, Accounting for Income Taxes. Regarding NOL's, the APB Opinion provides that if loss carryforwards are realized in periods subsequent to the loss period, the amounts eliminated from the deferred tax credit account should be reinstated at the then current tax rates. We conclude that the taxpayer's methodology satisfies the normalization requirements of sections 167 and 168 of the Code.

Accordingly, to the extent that the use of ACRS depreciation in 1986 and prior years in determining depreciation expense for Federal income tax purposes contributed to a NOL carryover from 1986 to 1987, the taxpayer's use of the effective tax rate for 1987 (39.95 percent for calendar year taxpayers) in computing the deferred Federal income tax expense on its regulated books of account for the year 1987 will be consistent with the normalization requirements of sections 167 and 168 of the Code and the regulations thereunder.

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

A copy of this private letter ruling is being sent to your authorized representative in accordance with the power of attorney on file with this office.

A copy of this ruling letter should be filed with the income tax return for the taxable year or years in which the transaction covered by this ruling is consummated.

Sincerely yours,
James F. Malloy
Director
Corporation Tax Division

This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code.

PLR 8818040, 1988 WL 571175 (IRS PLR)

END OF DOCUMENT

IRS Private Letter Ruling 201436037

PNM Exhibit MFH-8

Is contained in the following 7 pages

Internal Revenue Service

Number: **201436037**

Release Date: 9/5/2014

Index Number: 167.22-01

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B06

PLR-148310-13

Date:

May 22, 2014

LEGEND:

Taxpayer =

Parent =

State A =

State B =

State C =

Commission A =

Commission B =

Commission C =

Year A =

Year B =

Date A =

Date B =

Date C =

Case =

Director =

Dear :

This letter responds to the request, dated November 25, 2013, of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

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Taxpayer is a regulated public utility incorporated in State A and State B. It is wholly owned by Parent. Taxpayer is engaged in the transmission, distribution, and supply of electricity in State A and State C. Taxpayer is subject to the regulatory jurisdiction of Commission A, Commission B, and Commission C with respect to terms and conditions of service and particularly the rates it may charge for the provision of service. Taxpayer's rates are established on a rate of return basis. Taxpayer takes accelerated depreciation, including "bonus depreciation" where available and, for each year beginning in Year A and ending in Year B, Taxpayer individually (as well as the consolidated return filed by Parent) has or expects to, produce a net operating loss (NOL). On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries – a "deferred tax asset" and a "deferred tax expense" - that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of an net operating loss carryover (NOLC). Taxpayer, for normalization purposes, calculates the portion of the NOLC attributable to accelerated depreciation using a "with or without" methodology, meaning that an NOLC is attributable to accelerated depreciation to the extent of the lesser of the accelerated depreciation or the NOLC.

Taxpayer filed a general rate case with Commission B on Date A (Case). The test year used in the Case was the 12 month period ending on Date B. In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized in accordance with Commission B policy and were not flowed thru to ratepayers. The data originally filed in Case included six months of forecast data, which the Taxpayer updated with actual data in the course of proceedings. In establishing the rate base on which Taxpayer was to be allowed to earn a return Commission B offset rate base by Taxpayer's ADIT balance, using a 13-month average of the month-end balances of the relevant accounts. Taxpayer argued that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Testimony by various other participants in Case argued against Taxpayer's proposed calculation of ADIT. One proposal made to Commission B was, if Commission B allowed Taxpayer to reduce the ADIT balance as Taxpayer proposed, then Taxpayer's income tax expense element of service should be reduced by that same amount.

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Commission B, in an order issued on Date C, allowed Taxpayer to reduce ADIT by the amount that Taxpayer calculates did not actually defer tax due to the presence of the NOLC and ordered Taxpayer to seek a ruling on the effects of an NOLC on ADIT. Rates went into effect on Date C.

Taxpayer proposed, and Commission B accepted, that it be permitted to annualize, rather than average, its reliability plant additions and to extend the period of anticipated reliability plant additions to be included in rate base for an additional quarter. Taxpayer also proposed, and Commission B accepted, that no additional ADIT be reflected as a result of these adjustments inasmuch as any additional book and tax depreciation produced by considering these assets would simply increase Taxpayer's NOLC and thus there would be no net impact on ADIT.

Taxpayer requests that we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balances offset by a portion of its NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with or without" basis would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
2. The imputation of incremental ADIT on account of the reliability plant addition adjustments described above would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.
3. Under the circumstances described above, any reduction in Taxpayer's tax expense element of cost of service to reflect the tax benefit of its NOLC would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

Law and Analysis

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

In order to use a normalization method of accounting, section 168(i)(9)(A)(i) of the Code 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 section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute

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regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 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 section 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 section 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.

Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(1)-1(a)(1) of the Income Tax Regulations 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 section 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(1)-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 section 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 section 167(a) using a subsection (1) method, then the amount and time of the deferral of tax

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liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

Section 1.167(1)-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 section 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 section 1.167(1)-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 section 167(a).

Section 1.167(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 section 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(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 section 1.167(1)-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(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

PLR-148310-13

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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.

In Case, Commission B has reduced rate base by Taxpayer's ADIT account, as modified by the account which Taxpayer has designed to calculate the effects of the NOLC. Section 1.167(1)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes. Further, while that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements. Section 1.167(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 ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the order by Commission B is in accord with the normalization requirements. The "with or without" methodology employed 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. Under these facts, any method other than the "with and without" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

Regarding the second issue, § 1.167(1)-(h)(6)(i) provides, as noted above, 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 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. Increasing Taxpayer's ADIT account by an amount representing those taxes that would have been deferred absent the NOLC increases the ADIT reserve account (which will then reduce rate base) beyond the permissible amount.

Regarding the third issue, reduction of Taxpayer's tax expense element of cost of service, we believe that such reduction would, in effect, flow through the tax benefits of accelerated depreciation deductions through to rate payers even though the Taxpayer has not yet realized such benefits. This would violate the normalization provisions.

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We rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balances offset by a portion of its NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with or without" basis would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
2. The imputation of incremental ADIT on account of the reliability plant addition adjustments described above would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.
3. Under the circumstances described above, any reduction in Taxpayer's tax expense element of cost of service to reflect the tax benefit of its NOLC would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
(Passthroughs & Special Industries)

cc:

IRS Private Letter Ruling 201436038

PNM Exhibit MFH-9

Is contained in the following 7 pages

PLR 201436038 - Section 167 - Depreciation

Internal Revenue Service
Department of the Treasury
Washington, DC 20224
Number: 201436038
Release Date: 9/5/2014
Index Number: 167.22-01
Third Party Communication:
Date of Communication:
Person To Contact:
Telephone Number:
Refer Reply To:
CC:PSI:B06
PLR-148311-13
Date:
May 22, 2014

LEGEND:

Taxpayer =
Parent =
State A =
State B =
State C =
Commission A =
Commission B =
Commission C =
Year A =
Year B =
Date A =
Date B =
Date C =
Case =
Director =
Dear [redacted data]:

This letter responds to the request, dated November 25, 2013, of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is a regulated public utility incorporated in State A and State B. It is wholly owned by Parent. Taxpayer is engaged in the transmission, distribution, and supply of electricity in State A and State C. Taxpayer is subject to the regulatory jurisdiction of Commission A, Commission B,

and Commission C with respect to terms and conditions of service and particularly the rates it may charge for the provision of service. Taxpayer's rates are established on a rate of return basis.

Taxpayer takes accelerated depreciation, including "bonus depreciation" where available and, for each year beginning in Year A and ending in Year B, Taxpayer individually (as well as the consolidated return filed by Parent) has or expects to, produce a net operating loss (NOL). On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries - a "deferred tax asset" and a "deferred tax expense" - that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of an net operating loss carryover (NOLC). Taxpayer, for normalization purposes, calculates the portion of the NOLC attributable to accelerated depreciation using a "with or without" methodology, meaning that an NOLC is attributable to accelerated depreciation to the extent of the lesser of the accelerated depreciation or the NOLC.

Taxpayer filed a general rate case with Commission B on Date A (Case). The test year used in the Case was the 12 month period ending on Date B. In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized in accordance with Commission B policy and were not flowed thru to ratepayers. The data originally filed in Case included six months of forecast data, which the Taxpayer updated with actual data in the course of proceedings. In establishing the rate base on which Taxpayer was to be allowed to earn a return Commission B offset rate base by Taxpayer's ADIT balance, using a 13month average of the month-end balances of the relevant accounts. Taxpayer argued that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Testimony by various other participants in Case argued against Taxpayer's proposed calculation of ADIT. One proposal made to Commission B was, if Commission B allowed Taxpayer to reduce the ADIT balance as Taxpayer proposed, then Taxpayer's income tax expense element of service should be reduced by that same amount.

Commission B, in an order issued on Date C, allowed Taxpayer to reduce ADIT by the amount that Taxpayer calculates did not actually defer tax due to the presence of the NOLC and ordered Taxpayer to seek a ruling on the effects of an NOLC on ADIT. Rates went into effect on Date C.

Taxpayer proposed, and Commission B accepted, that it be permitted to annualize, rather than average, its reliability plant additions and to extend the period of anticipated reliability plant additions to be included in rate base for an additional quarter. Taxpayer also proposed, and Commission B accepted, that no additional ADIT be reflected as a result of these adjustments inasmuch as any additional book and tax depreciation produced by considering these assets would simply increase Taxpayer's NOLC and thus there would be no net impact on ADIT.

Taxpayer requests that we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balances offset by a portion of its NOLC related account balance that is less than the amount attributable to accelerated depreciation computed on a "with or without" basis would be inconsistent with the requirements of §168(i)(9) and §1.167(l)-1 of the Income Tax regulations.
2. The imputation of incremental ADIT on account of the reliability plant addition adjustments described above would be inconsistent with the requirements of § 168(i)(9) and §1.167(l)-1.
3. Under the circumstances described above, any reduction in Taxpayer's tax expense element of cost of service to reflect the tax benefit of its NOLC would be inconsistent with the requirements of §168(i)(9) and §1.167(l)-1.

Law and Analysis

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

In order to use a normalization method of accounting, section 168(i)(9)(A)(i) of the Code 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 section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 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 section 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 section 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.

Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(l)-1(a)(1) of the Income Tax

Regulations 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 section 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(1)-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 section 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 section 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(1)-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 section 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 section 1.167(1)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 section 167(a).

Section 1.167(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 section 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(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 section 1.167(1)-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(1)-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(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.

In Case, Commission B has reduced rate base by Taxpayer's ADIT account, as modified by the account which Taxpayer has designed to calculate the effects of the NOLC. Section 1.167(1)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes. Further, while that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements. Section 1.167(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 ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the order by Commission B is in accord with the normalization requirements. The "with or without" methodology employed 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. Under these facts, any method other than the "with and without" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

Regarding the second issue, §1.167(1)-(h)(6)(i) provides, as noted above, 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 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. Increasing Taxpayer's ADIT account by an amount representing those taxes that would have been deferred absent the NOLC increases the ADIT reserve account (which will then reduce rate base) beyond the permissible amount.

Regarding the third issue, reduction of Taxpayer's tax expense element of cost of service, we believe that such reduction would, in effect, flow through the tax benefits of accelerated depreciation deductions through to rate payers even though the Taxpayer has not yet realized such benefits. This would violate the normalization provisions.

We rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balances offset by a portion of its NOLC related account balance that is less than the amount attributable to accelerated depreciation computed on a "with or without" basis would be inconsistent with the requirements of §168(i)(9) and §1.167(l)-1 of the Income Tax regulations.
2. The imputation of incremental ADIT on account of the reliability plant addition adjustments described above would be inconsistent with the requirements of § 168(i)(9) and §1.167(l)-1.
3. Under the circumstances described above, any reduction in Taxpayer's tax expense element of cost of service to reflect the tax benefit of its NOLC would be inconsistent with the requirements of §168(i)(9) and §1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
(Passthroughs & Special Industries)

cc:

IRS Private Letter Ruling 201438003

PNM Exhibit MFH-10

Is contained in the following 7 pages

PLR 201438003, 2014 WL 4650274 (IRS PLR)

Internal Revenue Service (I.R.S.)

IRS PLR

Private Letter Ruling

Issue: September 19, 2014

June 12, 2014

Section 167 -- Depreciation167.00-00 Depreciation

167.22-00 Public Utility Property

167.22-01 Normalization Rules

CC:PSI:B06

PLR-104157-14

LEGEND:

Taxpayer =

Parent =

State A =

Commission A =

Commission B =

Year A =

Year B =

Year C =

Year D =

Date A =

Date B =

Date C =

Date D =

Case =

Director =

Dear ***:

This letter responds to the request, dated January 24, 2014, and additional submission dated May 19, 2014, submitted on behalf of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is a regulated, investor-owned public utility incorporated under the laws of State A primarily engaged in the business of supplying electricity in State A. Taxpayer is subject to the regulatory jurisdiction of Commission A and Commission B with respect to terms and conditions of service and particularly the rates it may charge for the provision of service. Taxpayer's rates are established on a rate of return basis.

Taxpayer is wholly owned by Parent, and Taxpayer is included in a consolidated federal income tax return of which Parent is the common parent. Taxpayer employs the accrual method of accounting and reports on a calendar year basis.

Taxpayer filed a rate case application on Date A (Case). In its filing, Taxpayer used as its starting point actual data from the historic test period, calendar Year A. It then projected data for Year B through Year C. Taxpayer updated, amended, and supplemented its data several times during the course of the proceedings. Rates in this proceeding were intended to, and did, go into effect for the period Date B through Date C.

In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized and were not flowed thru to ratepayers.

In its rate case filing, Taxpayer anticipated that it would claim accelerated depreciation, including “bonus depreciation” on its tax returns to the extent that such depreciation was available in all years for which data was provided. Additionally, Taxpayer forecasted that it would incur a net operating loss (NOL) in Year D. Taxpayer anticipated that it had the capacity to carry back a portion of this NOL with the remainder producing a net operating loss carryover (NOLC) as of the end of Year D.

On its regulatory books of account, Taxpayer “normalizes” the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute “cost-free capital” to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries - a “deferred tax asset” and a “deferred tax expense” - that reflect that portion of those ‘tax losses’ which, while due to accelerated depreciation, did not actually defer tax because of the existence of an NOLC.

In the setting of utility rates in State, a utility's rate base is offset by its ADIT balance. In its rate case filing and throughout the proceeding, Taxpayer maintained that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Thus, Taxpayer argued that the rate base should be reduced as of the end of Year D by its federal ADIT balance net of the deferred tax asset account attributable to the federal NOLC. It based this position on its determination that this net amount represented the true measure of federal income taxes deferred on account of its claiming accelerated tax depreciation deductions and, consequently, the actual quantity of “cost-free” capital available to it. It also asserted that the failure to reduce its rate base offset by the deferred tax asset attributable to the federal NOLC would be inconsistent with the normalization rules. Testimony by another participant in Case argued against Taxpayer's proposed calculation of ADIT.

Commission A, in an order issued on Date D, held that it is inappropriate to include the NOL in rate base for rate-making purposes. Commission A further stated that it is the intent of the Commission that Taxpayer comply with the normalization method of accounting and tax normalization regulations. Commission noted that if Taxpayer later obtains a ruling from the IRS which affirms Taxpayer's position, Taxpayer may file seeking an adjustment. Commission A also held that to the extent tax normalization rules require recording the NOL to rate base in the specified years, no rate of return is authorized.

Taxpayer requests that we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a “with and without” basis would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
3. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's

NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1.

Law and Analysis

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

In order to use a normalization method of accounting, section 168(i)(9)(A)(i) of the Code 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 section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 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 section 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 section 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.

Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(l)-1(a)(1) of the Income Tax Regulations 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 section 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 section 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 section 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 section 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 section 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 section 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 section 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 section 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.

Regarding the first issue, § 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 ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the order by Commission A is not in accord with the normalization requirements.

Regarding the second issue, § 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. While that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements. The "with or without" methodology employed 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. Under these facts, any method other than the "with and without" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

Regarding the third issue, assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would, in effect, flow the tax benefits of accelerated depreciation deductions through to rate payers. This would violate the normalization provisions.

We rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with and without" basis would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
3. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,
Peter C. Friedman
Senior Technician Reviewer, Branch 6 (Passthroughs & Special Industries)

cc:

Section 6110(j)(3) of the Internal Revenue Code This document may not be used or cited as precedent. .

PLR 201438003, 2014 WL 4650274 (IRS PLR)

END OF DOCUMENT

IRS Private Letter Ruling 201519021

PNM Exhibit MFH-11

Is contained in the following 7 pages

PLR 201519021, 2015 WL 2148898 (IRS PLR)

Internal Revenue Service (I.R.S.)
IRS PLR

Private Letter Ruling

Issue: May 8, 2015
February 4, 2015

Section 167 -- Depreciation167.00-00 Depreciation

167.22-00 Public Utility Property

167.22-01 Normalization Rules

CC:PSI:B06
PLR-136851-14

LEGEND:
Taxpayer =

Parent =

State A =

Commission =

Year A =

Year B =

Year C =

Year D =

Date A =

Date B =

Date C =

Date D =

Case =

Director =

Dear ***:

This letter responds to the request, dated October 1, 2014, submitted on behalf of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is a regulated, investor-owned public utility incorporated under the laws of State A primarily engaged in the business of supplying natural gas service in State A. Taxpayer is subject to the regulatory jurisdiction of Commission with respect to terms and conditions of service and as to the rates it may charge for the provision of service. Taxpayer's rates are established on a cost of service basis.

Taxpayer is wholly owned by Parent, and Taxpayer is included in a consolidated federal income tax return of which Parent is the common parent. Taxpayer employs the accrual method of accounting and reports on a calendar year basis.

Taxpayer filed a rate case application on Date A (Case). In its filing, Taxpayer used as its starting point actual data from the historic test period, calendar Year A. It then projected data for Year B through Year D. Taxpayer updated, amended, and supplemented its data several times during the course of the proceedings. Rates in this proceeding were intended to, and did, go into effect for the period Date B through Date C.

In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized and were not flowed thru to ratepayers.

In its rate case filing, Taxpayer anticipated that it would claim accelerated depreciation, including "bonus depreciation" on its tax returns to the extent that such depreciation was available in all years for which data was provided.

Additionally, Taxpayer forecasted that it would incur a net operating loss (NOL) in each of Year B, Year C, and Year D. Taxpayer anticipated that it had the capacity to carry back a portion of this NOL with the remainder producing a net operating loss carryover (NOLC) as of the end of Year C and Year D, the beginning and end of the test period.

On its regulatory books of account, Taxpayer “normalizes” the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute “cost-free capital” to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an off-setting series of entries — a “deferred tax asset” and a “deferred tax expense” - that reflect that portion of those ‘tax losses’ which, while due to accelerated depreciation, did not actually defer tax because of the existence of an NOLC.

In the setting of utility rates in State, a utility's rate base is offset by its ADIT balance. In its rate case filing and throughout the proceeding, Taxpayer maintained that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Thus, Taxpayer argued that the rate base should be reduced as of the end of Year D by its federal ADIT balance net of the deferred tax asset account attributable to the federal NOLC. It based this position on its determination that this net amount represented the true measure of federal income taxes deferred on account of its claiming accelerated tax depreciation deductions and, consequently, the actual quantity of “cost-free” capital available to it. It also asserted that the failure to reduce its rate base offset by the deferred tax asset attributable to the federal NOLC would be inconsistent with the normalization rules. Testimony by another participant in Case argued against Taxpayer's proposed calculation of ADIT.

Commission, in an order issued on Date D, held that it is inappropriate to include the NOL in rate base for ratemaking purposes. Commission further stated that it is the intent of the Commission that Taxpayer comply with the normalization method of accounting and tax normalization regulations. Commission noted that if Taxpayer later obtains a ruling from the IRS which affirms Taxpayer's position, Taxpayer may file seeking an adjustment. Commission also held that to the extent tax normalization rules require including the NOL in rate base in the specified years, no rate of return is authorized.

Taxpayer requests that we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a “with and without” basis would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
3. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1.

Law and Analysis

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

In order to use a normalization method of accounting, section 168(i)(9)(A)(i) of the Code 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 section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 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 section 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 section 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.

Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(l)-1(a)(1) of the Income Tax Regulations 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 section 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 section 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 section 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 section 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 section 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 section 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 section 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 section 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.

Regarding the first issue, § 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 ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the order by Commission is not in accord with the normalization requirements.

Regarding the second issue, § 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. While that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements. The "with or without" methodology employed 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. Under these specific facts, any method other than the "with and without" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

Regarding the third issue, assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would, in effect, flow the tax benefits of accelerated depreciation deductions through to rate payers. This would violate the normalization provisions.

We rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with and without" basis would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
3. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,
Peter C. Friedman
Senior Technician Reviewer, Branch 6
Office of the Associate Chief Counsel (Passthroughs & Special Industries)

Section 6110(j)(3) of the Internal Revenue Code This document may not be used or cited as precedent. .

PLR 201519021, 2015 WL 2148898 (IRS PLR)

END OF DOCUMENT

IRS Private Letter Ruling 201534001

PNM Exhibit MFH-12

Is contained in the following 4 pages

Private Letter Ruling, PLR 201534001 (2015)

PLR 201534001 (IRS PLR), 2015 WL 4978111

Internal Revenue Service (I.R.S.)

IRS PLR
Private Letter Ruling

Issue: August 21, 2015
May 13, 2015

Section 167 -- Depreciation
167.00-00 Depreciation
167.22-00 Public Utility Property
167.22-01 Normalization Rules

CC:PSI:B06

PLR-103300-15

LEGEND:

Taxpayer =

State A =

State B =

State C =

Commission =

Year A =

Year B =

Date A =

Date B =

Date C =

Date D =

Case =

Director =

Dear ***:

This letter responds to the request, dated January 9, 2015, submitted on behalf of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is the common parent of an affiliated group of corporations and is incorporated under the laws of State A and State B. Taxpayer is engaged primarily in the businesses of regulated natural gas distribution, regulated natural gas transmission, and regulated natural gas storage. Taxpayer's regulated natural gas distribution business delivers gas to customers in several states, including State A. Taxpayer is subject to, as relevant for this ruling, the regulatory jurisdiction of Commission with respect to

Private Letter Ruling, PLR 201534001 (2015)

terms and conditions of service and as to the rates it may charge for the provision of its gas distribution service in State A. Taxpayer's rates are established on a "rate of return" basis.

Taxpayer filed a rate case application on Date A (Case). In its filing, Taxpayer's application was based on a fully forecasted test period consisting of the twelve months ending on Date B. Taxpayer updated, amended, and supplemented its data several times during the course of the proceedings. In a final order dated Date C, rates were approved by Commission for service rendered on or after Date D.

In each year from Year A to Year B, Taxpayer incurred a net operating loss carryforward (NOLC). In each of these years, Taxpayer claimed accelerated depreciation, including "bonus depreciation" on its tax returns to the extent that such depreciation was available. On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries — a "deferred tax asset" and a "deferred tax expense" — that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of an NOLC.

In the setting of utility rates in State C, a utility's rate base is offset by its ADIT balance. In its rate case filing and throughout the proceeding, Taxpayer maintained that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Thus, Taxpayer argued that the rate base should be reduced by its federal ADIT balance net of the deferred tax asset account attributable to the federal NOLC. It also asserted that the failure to reduce its rate base offset by the deferred tax asset attributable to the federal NOLC would be inconsistent with the normalization rules. The attorney general for State C argued against Taxpayer's proposed calculation of ADIT.

Commission, in its final order, agreed with Taxpayer but concluded that the ambiguity in the relevant normalization regulations warranted an assessment of the issue by the IRS and this ruling request followed.

Taxpayer requests that we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account that is less than the amount attributable to accelerated depreciation computed on a "last dollars deducted" basis would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.

Law and Analysis

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

In order to use a normalization method of accounting, section 168(i)(9)(A)(i) of the Code 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 section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 168(i)(9)(A) will not be satisfied is if the

Private Letter Ruling, PLR 201534001 (2015)

taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under section 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 section 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.

Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(l)-1(a)(1) of the Income Tax Regulations 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 section 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 section 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 section 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 section 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 section 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 section 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 section 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 section 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

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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.

Regarding the first issue, § 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 ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, to reduce Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

Regarding the second issue, § 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. While that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements. The "last dollars deducted" methodology employed by Taxpayer ensures 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. Under these specific facts, any method other than the "last dollars deducted" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
Office of the Associate Chief Counsel (Passthroughs & Special Industries)

cc:

Section 6110(j)(3) of the Internal Revenue Code This document may not be used or cited as precedent. .
PLR 201534001 (IRS PLR), 2015 WL 4978111

End of Document

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IRS Private Letter Ruling 201548017

PNM Exhibit MFH-13

Is contained in the following 5 pages

Private Letter Ruling, PLR 201548017 (2015)

PLR 201548017 (IRS PLR), 2015 WL 7628781

Internal Revenue Service (I.R.S.)

IRS PLR
Private Letter RulingIssue: November 27, 2015
August 19, 2015Section 167 -- Depreciation
167.00-00 Depreciation
167.22-00 Public Utility Property
167.22-01 Normalization Rules

CC:PSI:B06

PLR-116998-15

LEGEND:

Taxpayer =

Parent =

State A =

State B =

Commission =

Year A =

Year B =

Date A =

Date B =

Case =

Director =

Dear ***:

This letter responds to the request, dated May 14, 2015, of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is primarily engaged in the regulated distribution of natural gas in State A. It is incorporated in State B and is wholly owned by Parent. Taxpayer is subject to the regulatory jurisdiction of Commission with respect to terms and conditions of service and particularly the rates it may charge for the provision of service. Taxpayer's rates are established on a rate of return basis. Taxpayer takes accelerated depreciation, including "bonus depreciation" where available and, for each year beginning in Year A and ending in Year B, Taxpayer incurred net operating losses (NOL). On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these

Private Letter Ruling, PLR 201548017 (2015)

differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries — a “deferred tax asset” and a “deferred tax expense” — that reflect that portion of those ‘tax losses’ which, while due to accelerated depreciation, did not actually defer tax because of the existence of an net operating loss carryover (NOLC). Taxpayer, for normalization purposes, calculates the portion of the NOLC attributable to accelerated depreciation using a “last dollars deducted” methodology, meaning that an NOLC is attributable to accelerated depreciation to the extent of the lesser of the accelerated depreciation or the NOLC.

Taxpayer filed a general rate case with Commission on Date A (Case). The test year used in the Case was the 12 month period ending on Date B. In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized in accordance with Commission policy and were not flowed thru to ratepayers. In establishing the rate base on which Taxpayer was to be allowed to earn a return Commission offsets rate base by Taxpayer’s ADIT balance. Taxpayer argued that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Testimony by various other participants in Case argued against Taxpayer’s proposed calculation of ADIT. One proposal made to Commission was, if Commission allowed Taxpayer to reduce the ADIT balance as Taxpayer proposed, then an offsetting reduction should be made to Taxpayer’s income tax expense element of service.

A Utility Law Judge upheld Taxpayer’s position with respect to the NOLC-related ADIT and ordered Taxpayer to seek a ruling from the Internal Revenue Service on this matter. This request is in response to that order.

Taxpayer requests that we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer’s rate base by the balance of its ADIT accounts unreduced by its NOLC-related deferred tax account would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
2. Under the circumstances described above, the reduction of Taxpayer’s rate base by the full amount of its ADIT account balances offset by a portion of its NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a “last dollars deducted” basis would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.
3. Under the circumstances described above, any reduction in Taxpayer’s tax expense element of cost of service to reflect the tax benefit of its NOLC would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

Law and Analysis

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

In order to use a normalization method of accounting, section 168(i)(9)(A)(i) of the Code 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 section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 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 section 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 section 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.

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Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a “normalization method of accounting.” A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(l)-1(a)(1) of the Income Tax Regulations 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 section 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 section 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 section 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 section 167(l) 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 section 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 section 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 section 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 section 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

Private Letter Ruling, PLR 201548017 (2015)

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(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes. Further, while that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements. Section 1.167(l)-(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 ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the proposed order by the Utility Law Judge upholding Taxpayer's position that the NOLC-related deferred tax account must be included in the calculation of Taxpayer's ADIT is in accord with the normalization requirements. The "last dollars deducted" methodology employed 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. Under these facts, any method other than the "last dollars deducted" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

Regarding the third issue, reduction of Taxpayer's tax expense element of cost of service, we believe that such reduction would, in effect, flow through the tax benefits of accelerated depreciation deductions through to rate payers even though the Taxpayer has not yet realized such benefits. In addition, such adjustment would be made specifically to mitigate the effect of the normalization rules in the calculation of Taxpayer's NOLC-related ADIT. In general, taxpayers may not adopt any accounting treatment that directly or indirectly circumvents the normalization rules. See generally, § 1.46-6(b)(2)(ii) (In determining whether, or to what extent, the investment tax credit has been used to reduce cost of service, reference shall be made to any accounting treatment that affects cost of service); Rev. Proc 88-12, 1988-1 C.B. 637, 638 (It is a violation of the normalization rules for taxpayers to adopt any accounting treatment that, directly or indirectly flows excess tax reserves to ratepayers prior to the time that the amounts in the vintage accounts reverse). This "offsetting reduction" would violate the normalization provisions.

Based on the representations submitted by Taxpayer, we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the balance of its ADIT accounts unreduced by its NOLC-related deferred tax account would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
2. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balances offset by a portion of its NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "last dollars deducted" basis would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.
3. Under the circumstances described above, any reduction in Taxpayer's tax expense element of cost of service to reflect the tax benefit of its NOLC would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel (Passthroughs & Special Industries)

Private Letter Ruling, PLR 201548017 (2015)

cc:

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PLR 201548017 (IRS PLR), 2015 WL 7628781

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Income Tax Expense on Palo Verde Sale-Leaseback Transactions

PNM Exhibit MFH-14

Is contained in the following 8 pages

	A	B	C	D	E
1	Public Service Company of New Mexico				PNM Exhibit MFH-14
2	Calculation of Income Tax Expense on Palo Verde Units 1 & 2 Sale Leasebacks				Page 1 of 8
3	NMPRC Case No. 16-00276-UT				
4					
5	Summary of Income Tax Expense and Income Tax Payable	Federal	State	Total	Reference
6					
7	Total Income Tax Expense resulting from the sale-leasbacks	(156,980,716)	(36,682,429)	(193,663,145)	Page 3, column B, Line 40
8	Less:				
9	Investment Tax Credit carryforwards utilized to reduce Federal Income Tax payable	80,723,897	-	80,723,897	Page 3, column C, Line 38
10	Add:				
11	Federal Income Tax deferred and receivable in later years	(4,851,033)	-	(4,851,033)	Page 3, column D, Line 23
12	State Income Tax deferred and receivable in later years	-	(759,290)	(759,290)	Page 3, column D, Line 16
13					
14	Income Taxes Payable at the time of the sale-leasbacks	(81,107,852)	(37,441,719)	(118,549,571)	Page 3, column C, Line 42

	A	B	C	D	E
1	Public Service Company of New Mexico				PNM Exhibit MFH-14
2	Calculation of Income Tax Expense on Palo Verde Units 1 & 2 Sale Leasebacks				Page 2 of 8
3	NMPRC Case No. 16-00276-UT				
4					
5	Reconciliation of Gains to 1985 & 1986 Federal Income Tax Returns	Gain			Reference
6	Capital Gain reported on 1985 Federal Income Tax Return	184,563,957			1985 IRS Form 4797, part III, column C, line 23
7	Total Gain reported on 1986 Federal Income Tax Return	330,666,658			1986 IRS Form 4797, part III, column A, line 23
8	Less: Ordinary Portion of Gain reported on 1986 Federal Income Tax Return	(5,882,881)			1986 IRS Form 4797, part III, column A, line 24(b)
9	Total Sale-Leaseback Capital Gain reported on Federal Income Tax Returns	509,347,734			
10	Rounding	1			
11	Capital Gain as Calculated	509,347,735			Page 3, column C, Line 21
12					
13	Ordinary Gain reported on 1985 IRS Form 4797, part II	5,493,020			1985 IRS Form 4797, part II, line 15, stmt 70
14	Ordinary Gain reported on 1986 IRS Form 4797, part II	18,607,028			1986 IRS Form 4797, part II, line 9, stmt 82
15	Ordinary Gain reported on 1986 IRS Form 4797, part III	5,882,881			1986 IRS Form 4797, part III, column A, line 24(b)
16	Total Sale-Leaseback Ordinary Income reported on Federal Tax Returns	29,982,929			
17					
18	Ordinary Gain (Loss) as Calculated	(7,458,765)			Page 3, column C, Line 20
19	State Income Tax payable included in state income tax expense	37,441,719			Page 3, column C, Line 16
20	Rounding	(26)			
21	Ordinary Gain as Calculated for inclusion on Federal Income Tax Returns	29,982,929			

	A	B	C	D
1	Public Service Company of New Mexico		PNM Exhibit MFH-14	
2	Calculation of Income Tax Expense on Palo Verde Units 1 & 2 Sale Leasebacks		Page 3 of 8	
3	NMPRC Case No. 16-00276-UT			
4				
5	Total	Total Tax Expense	Current Tax Expense	Deferred Tax Expense
6				
7	Sales Price	900,526,144	900,526,144	-
8	Sales Expenses	(20,216,653)	(20,216,653)	-
9	Total Cost Basis of Plant Sold	(644,312,420)	(644,312,420)	-
10	Book Pre-Tax Gain	235,997,071	235,997,071	-
11	Permanent Differences and Flow-Throughs:			
12	AFUDC	212,395,079	212,395,079	-
13	Start-up and O&M	78,060,868	78,060,868	-
14	AR-13 Basis Difference	(717,007)	(717,007)	-
15	Energy Sales	2,289,665	2,289,665	-
16	Total Permanent Differences and Flow-throughs	292,028,605	292,028,605	-
17				
18	Taxable Gain for Book Purposes	528,025,676	528,025,676	-
19	Temporary Book/Tax Differences:			
20	Deferred Start-up	-	5,639,332	(5,639,332)
21	Excess Tax Depreciation	-	5,665,682	(5,665,682)
22	State Taxable Gain	528,025,676	539,330,690	(11,305,014)
23				
24	State Tax Rate			
25	Current State Tax Payable on Line 11	(36,643,224)	(37,441,719)	798,495
26	Adjustment to Deferred Taxes for State Rate Increase	(39,205)	-	(39,205)
27	Total State Income Tax Expense	(36,682,429)	(37,441,719)	759,290
28				
29	Federal Taxable Gain	491,343,247	501,888,971	(10,545,724)
30				
31	Ordinary Gain	(18,004,489)	(7,458,765)	(10,545,724)
32	Capital Gain	509,347,735	509,347,735	-
33				
34	Federal Income Tax on Ordinary Income at 46%	8,282,065	3,431,032	4,851,033
35	Federal Income Tax on Capital Gain at 28%	(142,617,366)	(142,617,366)	-
36				-
37	Federal Minimum Tax			
38	Capital Gain		509,347,735	-
39	Times: 18/46		18/46	
40			199,309,983	
41	Federal Ordinary Income Tax		3,431,032	
42	Federal Capital Gains Tax		(142,617,366)	
43	ITC Utilization		80,723,897	
44	Total Subject to Minimum Tax		140,847,546	
45	Minimum Tax Rate		15%	
46			(21,127,138)	
47	Other Adjustments		(567,099)	
48	Federal Minimum Tax	(21,694,237)	(21,694,237)	-
49	ITC Utilization		80,723,897	(80,723,897)
50	Amended Federal Returns and Carryback Claims	(951,178)	(951,178)	-
51	Total Federal Income Tax Expense	(156,980,716)	(81,107,852)	(75,872,864)
52				
53	Total Federal and State Income Tax Expense	(193,663,145)	(118,549,571)	(75,113,574)

	A	B	C	D
1	Public Service Company of New Mexico		PNM Exhibit MFH-14	
2	Calculation of Income Tax Expense on Palo Verde Units 1 & 2 Sale Leasebacks		Page 4 of 8	
3	NMPRC Case No. 16-00276-UT			
4				
5	Unit 1 12/85	Total Tax Expense	Current Tax Expense	Deferred Tax Expense
6				
7	Sales Price	325,153,445	325,153,445	
8	Sales Expenses	(4,053,445)	(4,053,445)	
9	Total Cost Basis of Plant Sold	(246,451,764)	(246,451,764)	
10	Book Pre-Tax Gain	74,648,236	74,648,236	-
11	Permanent Differences and Flow-Throughs:			
12	AFUDC	84,504,503	84,504,503	
13	Start-up and O&M	30,904,230	30,904,230	
14	AR-13 Basis Difference			
15	Energy Sales			
16	Total Permanent Differences and Flow-throughs	115,408,733	115,408,733	-
17				
18	Taxable Gain for Book Purposes	190,056,969	190,056,969	-
19	Temporary Book/Tax Differences:			
20	Deferred Start-up			-
21	Excess Tax Depreciation			-
22	State Taxable Gain	190,056,969	190,056,969	-
23				
24	State Tax Rate	6.72%	6.72%	6.72%
25	Current State Tax Payable on Line 11	(12,771,828)	(12,771,828)	-
26	Adjustment to Deferred Taxes for State Rate Increase			
27	Total State Income Tax Expense	(12,771,828)	(12,771,828)	-
28				
29	Federal Taxable Gain	177,285,141	177,285,141	-
30				
31	Ordinary Gain	(7,278,809)	(7,278,809)	-
32	Capital Gain	184,563,950	184,563,950	-
33				
34	Federal Income Tax on Ordinary Income at 46%	3,348,252	3,348,252	-
35	Federal Income Tax on Capital Gain at 28%	(51,677,906)	(51,677,906)	-
36				
37	Federal Minimum Tax			
38	Capital Gain		184,563,950	
39	Times: 18/46		18/46	
40			72,220,676	
41	Federal Ordinary Income Tax		3,348,252	
42	Federal Capital Gains Tax		(51,677,906)	
43	ITC Utilization		41,080,208	
44	Total Subject to Minimum Tax		64,971,230	
45	Minimum Tax Rate		15%	
46			(9,745,685)	
47	Other Adjustments			
48	Federal Minimum Tax	(9,745,685)	(9,745,685)	-
49	ITC Utilization		41,080,208	(41,080,208)
50	Amended Federal Returns and Carryback Claims			
51	Total Federal Income Tax Expense	(58,075,338)	(16,995,130)	(41,080,208)
52				
53	Total Federal and State Income Tax Expense	(70,847,167)	(29,766,959)	(41,080,208)

	A	B	C	D
1	Public Service Company of New Mexico		PNM Exhibit MFH-14	
2	Calculation of Income Tax Expense on Palo Verde Units 1 & 2 Sale Leasebacks		Page 5 of 8	
3	NMPRC Case No. 16-00276-UT			
4				
5	Unit 1 08/86	Total Tax Expense	Current Tax Expense	Deferred Tax Expense
6				
7	Sales Price	50,019,417	50,019,417	
8	Sales Expenses	(716,551)	(716,551)	
9	Total Cost Basis of Plant Sold	(38,183,386)	(38,183,386)	
10	Book Pre-Tax Gain	11,119,480	11,119,480	-
11	Permanent Differences and Flow-Throughs:			
12	AFUDC	12,963,477	12,963,477	
13	Start-up and O&M	5,241,913	5,241,913	
14	AR-13 Basis Difference	(139,500)	(139,500)	
15	Energy Sales	139,639	139,639	
16	Total Permanent Differences and Flow-throughs	18,205,529	18,205,529	-
17				
18	Taxable Gain for Book Purposes	29,325,009	29,325,009	-
19	Temporary Book/Tax Differences:			
20	Deferred Start-up		630,271	(630,271)
21	Excess Tax Depreciation		1,902,092	(1,902,092)
22	State Taxable Gain	29,325,009	31,857,372	(2,532,363)
23				
24	State Tax Rate	7.06%	7.06%	7.06%
25	Current State Tax Payable on Line 11	(2,071,283)	(2,250,149)	178,866
26	Adjustment to Deferred Taxes for State Rate Increase	(8,782)		(8,782)
27	Total State Income Tax Expense	(2,080,065)	(2,250,149)	170,084
28				
29	Federal Taxable Gain	27,244,944	29,607,223	(2,362,279)
30				
31	Ordinary Gain	(2,450,872)	(88,592)	(2,362,279)
32	Capital Gain	29,695,815	29,695,815	-
33				
34	Federal Income Tax on Ordinary Income at 46%	1,127,401	40,752	1,086,649
35	Federal Income Tax on Capital Gain at 28%	(8,314,828)	(8,314,828)	-
36				
37	Federal Minimum Tax			
38	Capital Gain		29,695,815	
39	Times: 18/46		18/46	
40			11,620,102	
41	Federal Ordinary Income Tax		40,752	
42	Federal Capital Gains Tax		(8,314,828)	
43	ITC Utilization		3,587,754	
44	Total Subject to Minimum Tax		6,933,780	
45	Minimum Tax Rate		15%	
46			(1,040,073)	
47	Other Adjustments			
48	Federal Minimum Tax	(1,040,073)	(1,040,073)	-
49	ITC Utilization		3,587,754	(3,587,754)
50	Amended Federal Returns and Carryback Claims			
51	Total Federal Income Tax Expense	(8,227,500)	(5,726,395)	(2,501,105)
52				
53	Total Federal and State Income Tax Expense	(10,307,566)	(7,976,544)	(2,331,022)

	A	B	C	D
1	Public Service Company of New Mexico		PNM Exhibit MFH-14	
2	Calculation of Income Tax Expense on Palo Verde Units 1 & 2 Sale Leasebacks		Page 6 of 8	
3	NMPRC Case No. 16-00276-UT			
4				
5	Unit 1 12/86	Total Tax Expense	Current Tax Expense	Deferred Tax Expense
6				
7	Sales Price	75,041,903	75,041,903	
8	Sales Expenses	(1,202,830)	(1,202,830)	
9	Total Cost Basis of Plant Sold	(57,625,696)	(57,625,696)	
10	Book Pre-Tax Gain	16,213,377	16,213,377	-
11	Permanent Differences and Flow-Throughs:			
12	AFUDC	19,451,050	19,451,050	
13	Start-up and O&M	7,862,869	7,862,869	
14	AR-13 Basis Difference	(209,313)	(209,313)	
15	Energy Sales	209,521	209,521	
16	Total Permanent Differences and Flow-throughs	27,314,127	27,314,127	-
17				
18	Taxable Gain for Book Purposes	43,527,504	43,527,504	-
19	Temporary Book/Tax Differences:			
20	Deferred Start-up		945,407	(945,407)
21	Excess Tax Depreciation		2,798,997	(2,798,997)
22	State Taxable Gain	43,527,504	47,271,908	(3,744,404)
23				
24	State Tax Rate	7.06%	7.06%	7.06%
25	Current State Tax Payable on Line 11	(3,074,433)	(3,338,908)	264,475
26	Adjustment to Deferred Taxes for State Rate Increase	(12,985)		(12,985)
27	Total State Income Tax Expense	(3,087,419)	(3,338,908)	251,489
28				
29	Federal Taxable Gain	40,440,085	43,933,000	(3,492,915)
30				
31	Ordinary Gain	(3,593,986)	(101,071)	(3,492,915)
32	Capital Gain	44,034,071	44,034,071	-
33				
34	Federal Income Tax on Ordinary Income at 46%	1,653,234	46,493	1,606,741
35	Federal Income Tax on Capital Gain at 28%	(12,329,540)	(12,329,540)	-
36				
37	Federal Minimum Tax			
38	Capital Gain		44,034,071	
39	Times: 18/46		18/46	
40			17,230,724	
41	Federal Ordinary Income Tax		46,493	
42	Federal Capital Gains Tax		(12,329,540)	
43	ITC Utilization		5,320,183	
44	Total Subject to Minimum Tax		10,267,859	
45	Minimum Tax Rate		15%	
46			(1,540,179)	
47	Other Adjustments			
48	Federal Minimum Tax	(1,540,179)	(1,540,179)	-
49	ITC Utilization		5,320,183	(5,320,183)
50	Amended Federal Returns and Carryback Claims			
51	Total Federal Income Tax Expense	(12,216,485)	(8,503,043)	(3,713,442)
52				
53	Total Federal and State Income Tax Expense	(15,303,904)	(11,841,951)	(3,461,953)

	A	B	C	D
1	Public Service Company of New Mexico		PNM Exhibit MFH-14	
2	Calculation of Income Tax Expense on Palo Verde Units 1 & 2 Sale Leasebacks		Page 7 of 8	
3	NMPRC Case No. 16-00276-UT			
4				
5	Unit 2 08/86	Total Tax Expense	Current Tax Expense	Deferred Tax Expense
6				
7	Sales Price	415,136,269	415,136,269	
8	Sales Expenses	(13,443,543)	(13,443,543)	
9	Total Cost Basis of Plant Sold	(278,781,195)	(278,781,195)	
10	Book Pre-Tax Gain	122,911,531	122,911,531	-
11	Permanent Differences and Flow-Throughs:			
12	AFUDC	88,048,012	88,048,012	
13	Start-up and O&M	31,402,621	31,402,621	
14	AR-13 Basis Difference	(339,549)	(339,549)	
15	Energy Sales	1,789,534	1,789,534	
16	Total Permanent Differences and Flow-throughs	120,900,618	120,900,618	-
17				
18	Taxable Gain for Book Purposes	243,812,149	243,812,149	-
19	Temporary Book/Tax Differences:			
20	Deferred Start-up		3,747,502	(3,747,502)
21	Excess Tax Depreciation		1,039,988	(1,039,988)
22	State Taxable Gain	243,812,149	248,599,639	(4,787,490)
23				
24	State Tax Rate	7.06%	7.06%	7.06%
25	Current State Tax Payable on Line 11	(17,220,932)	(17,559,082)	338,150
26	Adjustment to Deferred Taxes for State Rate Increase	(16,603)		(16,603)
27	Total State Income Tax Expense	(17,237,535)	(17,559,082)	321,547
28				
29	Federal Taxable Gain	226,574,614	231,040,557	(4,465,943)
30				
31	Ordinary Gain	(3,197,674)	1,268,269	(4,465,943)
32	Capital Gain	229,772,288	229,772,288	-
33				
34	Federal Income Tax on Ordinary Income at 46%	1,470,930	(583,404)	2,054,334
35	Federal Income Tax on Capital Gain at 28%	(64,336,241)	(64,336,241)	-
36				
37	Federal Minimum Tax			
38	Capital Gain		229,772,288	
39	Times: 18/46		18/46	
40			89,910,895	
41	Federal Ordinary Income Tax		(583,404)	
42	Federal Capital Gains Tax		(64,336,241)	
43	ITC Utilization		28,309,558	
44	Total Subject to Minimum Tax		53,300,809	
45	Minimum Tax Rate		15%	
46			(7,995,121)	
47	Other Adjustments		(567,099)	
48	Federal Minimum Tax	(8,562,220)	(8,562,220)	-
49	ITC Utilization		28,309,558	(28,309,558)
50	Amended Federal Returns and Carryback Claims	(951,178)	(951,178)	
51	Total Federal Income Tax Expense	(72,378,709)	(46,123,485)	(26,255,224)
52				
53	Total Federal and State Income Tax Expense	(89,616,244)	(63,682,567)	(25,933,677)

	A	B	C	D
1	Public Service Company of New Mexico		PNM Exhibit MFH-14	
2	Calculation of Income Tax Expense on Palo Verde Units 1 & 2 Sale Leasebacks		Page 8 of 8	
3	NMPRC Case No. 16-00276-UT			
4				
5	Unit 2 12/86	Total Tax Expense	Current Tax Expense	Deferred Tax Expense
6				
7	Sales Price	35,175,110	35,175,110	
8	Sales Expenses	(800,284)	(800,284)	
9	Total Cost Basis of Plant Sold	(23,270,379)	(23,270,379)	
10	Book Pre-Tax Gain	11,104,447	11,104,447	-
11	Permanent Differences and Flow-Throughs:			
12	AFUDC	7,428,037	7,428,037	
13	Start-up and O&M	2,649,235	2,649,235	
14	AR-13 Basis Difference	(28,645)	(28,645)	
15	Energy Sales	150,971	150,971	
16	Total Permanent Differences and Flow-throughs	10,199,598	10,199,598	-
17				
18	Taxable Gain for Book Purposes	21,304,045	21,304,045	-
19	Temporary Book/Tax Differences:			
20	Deferred Start-up		316,152	(316,152)
21	Excess Tax Depreciation		(75,395)	75,395
22	State Taxable Gain	21,304,045	21,544,802	(240,757)
23				
24	State Tax Rate	7.06%	7.06%	7.06%
25	Current State Tax Payable on Line 11	(1,504,747)	(1,521,752)	17,005
26	Adjustment to Deferred Taxes for State Rate Increase	(835)		(835)
27	Total State Income Tax Expense	(1,505,582)	(1,521,752)	16,170
28				
29	Federal Taxable Gain	19,798,463	20,023,050	(224,587)
30				
31	Ordinary Gain	(1,483,148)	(1,258,561)	(224,587)
32	Capital Gain	21,281,611	21,281,611	-
33				
34	Federal Income Tax on Ordinary Income at 46%	682,248	578,938	103,310
35	Federal Income Tax on Capital Gain at 28%	(5,958,851)	(5,958,851)	-
36				
37	Federal Minimum Tax			
38	Capital Gain		21,281,611	
39	Times: 18/46		18/46	
40			8,327,587	
41	Federal Ordinary Income Tax		578,938	
42	Federal Capital Gains Tax		(5,958,851)	
43	ITC Utilization		2,426,194	
44	Total Subject to Minimum Tax		5,373,868	
45	Minimum Tax Rate		15%	
46			(806,080)	
47	Other Adjustments			
48	Federal Minimum Tax	(806,080)	(806,080)	-
49	ITC Utilization		2,426,194	(2,426,194)
50				
51	Total Federal Income Tax Expense	(6,082,683)	(3,759,799)	(2,322,884)
52				
53	Total Federal and State Income Tax Expense	(7,588,265)	(5,281,551)	(2,306,714)

Gain on Palo Verde Sale-Leaseback Transactions

PNM Exhibit MFH-15

Is contained in the following 1 page

	A	B	C	D	E	F	G	H	I	J
1	Public Service Company of New Mexico									PNM Exhibit MFH-15
2	Calculation of Deferred Gain on Palo Verde Units 1 & 2 Sale Leasebacks									Page 1 of 1
3	NMPRC Case No. 16-00276-UT									
4										
5	Description	Unit 1 12/85	Unit 1 08/86	Unit 1 12/86	Unit 2 08/86	Unit 2 12/86		Unit 1	Unit 2	Total
6										
7	Sales Price	325,153,445	50,019,417	75,041,903	415,136,269	35,175,110		450,214,765	450,311,379	900,526,144
8	Sales Expenses	(4,053,445)	(716,551)	(1,202,830)	(13,443,543)	(800,284)		(5,972,826)	(14,243,827)	(20,216,653)
9	Total Cost Basis of Plant Sold	(246,451,764)	(38,183,386)	(57,625,696)	(278,781,195)	(23,270,379)		(342,260,846)	(302,051,574)	(644,312,420)
10	Book Pre-Tax Gain	74,648,236	11,119,480	16,213,377	122,911,531	11,104,447		101,981,093	134,015,978	235,997,071
11	Income Taxes Payable at the time of the sale-leasebacks	(29,766,959)	(7,976,544)	(11,841,951)	(63,682,567)	(5,281,551)		(49,585,454)	(68,964,118)	(118,549,572)
12	ITC utilized and required to be normalized	(41,080,208)	(3,587,754)	(5,320,183)	(28,309,558)	(2,426,194)		(49,988,145)	(30,735,752)	(80,723,897)
13	Deferred Income Taxes (Payable) Receivable		1,256,732	1,858,230	2,375,881	119,480		3,114,962	2,495,361	5,610,323
14	After-Tax Gain for Ratemaking Purposes	3,801,069	811,914	909,473	33,295,287	3,516,182		5,522,456	36,811,469	42,333,925

Palo Verde Gain Hypothetical Revenue Requirements

PNM Exhibit MFH-16

Is contained in the following 3 pages

	A	B	C	D	E
1	Public Service Company of New Mexico				PNM Exhibit MFH-16
2	Hypothetical First Year Revenue Requirement for PVNGS Sale Leasebacks				Page 1 of 3
3	NMPRC Case No. 16-00276-UT				
4					
5		Net of Tax Gain	Gross Gain		
6					
7	Unamortized Gain	(42,333,925)	(235,997,071)		
8	ADIT Asset - Prepaid Tax on Gain		193,663,146		
9	Total Rate Base	(42,333,925)	(42,333,925)		
10					
11	Return on Rate Base at 8.17%	(3,458,682)	(3,458,682)		
12	Gain Amortization (15 yr)	(2,822,262)	(15,733,138)		
13	Income Taxes (calculated below)	(3,229,060)	9,681,817		
14	Revenue Requirement	(9,510,003)	(9,510,003)		
15			-		
16					
17	Federal Tax Calculation:				
18	Return on Rate Base	(3,458,682)	(3,458,682)		
19	Adjustments:				
20	Interest on Long-Term Debt at 2.94%	1,244,617	1,244,617		
21	Gain Amortization Flow Through	(2,822,262)			
22	Basis Differences on Sale		19,468,574		
23	Prepaid Tax Adjustment				
24	Net Taxable Equity Return	(5,036,326)	17,254,509		
25					
26	Federal Income Tax at 35% grossed up	(2,711,868)	9,290,890		
27	Rate Differential, grossed up at 35%		(1,294,566)		
28	Rate Differential, grossed up at 35%				
29	Total Federal Income Tax	(2,711,868)	7,996,324		
30					
31	State Tax Calculation:				
32	Return on Rate Base	(3,458,682)	(3,458,682)		
33	Adjustments:				
34	Interest on Long-Term Debt at 2.94%	1,244,617	1,244,617		
35	Tax/Book Adjustments:	(2,822,262)	19,468,574		
36	Add: Net Allowable FIT	(2,711,868)	7,996,324		
37	State Taxable Income	(7,748,194)	25,250,833		
38					
39	State Income Taxes at 6.675%	(517,192)	1,685,493		
40					
41	Total Income Tax Expense	(3,229,060)	9,681,817		
42					
43	Assumptions used for illustrative cost of service comparison:				
44	Rate base includes beginning balance of Deferred Gain and ADIT				
45	Gain is amortized over 15 years				
46	Tax Rates are equal to Tax Rates used in Test Period				
47	WACC is equal to WACC used in Test Period				

Net of Tax Gain

Year	Unamortized Gain	ADIT	Total Rate Base	Book/Tax Differences	Equity Return at 5.23%	Debt Return at 2.94%	Gain Amortization	Federal Income Tax at 35%	State Income Tax at 6.675%	Tax Rate Differential	Total Revenue Requirement
1	(42,333,925)		(42,333,925)	(2,822,262)	(2,214,064)	(1,244,617)	(2,822,262)	(2,711,868)	(517,192)		(9,510,003)
2	(39,511,663)		(39,511,663)	(2,822,262)	(2,066,460)	(1,161,643)	(2,822,262)	(2,632,389)	(502,034)		(9,184,787)
3	(36,689,402)		(36,689,402)	(2,822,262)	(1,918,856)	(1,078,668)	(2,822,262)	(2,552,909)	(486,876)		(8,859,571)
4	(33,867,140)		(33,867,140)	(2,822,262)	(1,771,251)	(995,694)	(2,822,262)	(2,473,430)	(471,718)		(8,534,356)
5	(31,044,878)		(31,044,878)	(2,822,262)	(1,623,647)	(912,719)	(2,822,262)	(2,393,951)	(456,561)		(8,209,140)
6	(28,222,617)		(28,222,617)	(2,822,262)	(1,476,043)	(829,745)	(2,822,262)	(2,314,472)	(441,403)		(7,883,924)
7	(25,400,355)		(25,400,355)	(2,822,262)	(1,328,439)	(746,770)	(2,822,262)	(2,234,992)	(426,245)		(7,558,708)
8	(22,578,093)		(22,578,093)	(2,822,262)	(1,180,834)	(663,796)	(2,822,262)	(2,155,513)	(411,087)		(7,233,492)
9	(19,755,832)		(19,755,832)	(2,822,262)	(1,033,230)	(580,821)	(2,822,262)	(2,076,034)	(395,929)		(6,908,276)
10	(16,933,570)		(16,933,570)	(2,822,262)	(885,626)	(497,847)	(2,822,262)	(1,996,555)	(380,772)		(6,583,061)
11	(14,111,308)		(14,111,308)	(2,822,262)	(738,021)	(414,872)	(2,822,262)	(1,917,076)	(365,614)		(6,257,845)
12	(11,289,047)		(11,289,047)	(2,822,262)	(590,417)	(331,898)	(2,822,262)	(1,837,596)	(350,456)		(5,932,629)
13	(8,466,785)		(8,466,785)	(2,822,262)	(442,813)	(248,923)	(2,822,262)	(1,758,117)	(335,298)		(5,607,413)
14	(5,644,523)		(5,644,523)	(2,822,262)	(295,209)	(165,949)	(2,822,262)	(1,678,638)	(320,140)		(5,282,197)
15	(2,822,262)		(2,822,262)	(2,822,262)	(147,604)	(82,974)	(2,822,262)	(1,599,159)	(304,982)		(4,956,981)
16	-		-	-	-	-	-	-	-		-
Total					(17,712,514)	(9,956,939)	(42,333,925)	(32,332,698)	(6,166,307)	-	(108,502,384)

Gross Gain

Year	Unamortized Gain	ADIT	Total Rate Base	Book/Tax Differences	Equity Return at 5.23%	Debt Return at 2.94%	Gain Amortization	Federal Income Tax at 35%	State Income Tax at 6.675%	Tax Rate Differential	Total Revenue Requirement
1	(235,997,071)	193,663,146	(42,333,925)	19,468,574	(2,214,064)	(1,244,617)	(15,733,138)	9,290,890	1,685,493	(1,294,566)	(9,510,003)
2	(220,263,933)	180,752,270	(39,511,663)	19,468,574	(2,066,460)	(1,161,643)	(15,733,138)	9,370,369	1,700,651	(1,294,566)	(9,184,787)
3	(204,530,795)	167,841,393	(36,689,402)	19,468,574	(1,918,856)	(1,078,668)	(15,733,138)	9,449,848	1,715,809	(1,294,566)	(8,859,571)
4	(188,797,657)	154,930,517	(33,867,140)	19,468,574	(1,771,251)	(995,694)	(15,733,138)	9,529,327	1,730,967	(1,294,566)	(8,534,356)
5	(173,064,519)	142,019,640	(31,044,878)	19,468,574	(1,623,647)	(912,719)	(15,733,138)	9,608,807	1,746,124	(1,294,566)	(8,209,140)
6	(157,331,381)	129,108,764	(28,222,617)	19,468,574	(1,476,043)	(829,745)	(15,733,138)	9,688,286	1,761,282	(1,294,566)	(7,883,924)
7	(141,598,243)	116,197,888	(25,400,355)	19,468,574	(1,328,439)	(746,770)	(15,733,138)	9,767,765	1,776,440	(1,294,566)	(7,558,708)
8	(125,865,105)	103,287,011	(22,578,093)	19,468,574	(1,180,834)	(663,796)	(15,733,138)	9,847,244	1,791,598	(1,294,566)	(7,233,492)
9	(110,131,966)	90,376,135	(19,755,832)	19,468,574	(1,033,230)	(580,821)	(15,733,138)	9,926,724	1,806,756	(1,294,566)	(6,908,276)
10	(94,398,828)	77,465,258	(16,933,570)	19,468,574	(885,626)	(497,847)	(15,733,138)	10,006,203	1,821,914	(1,294,566)	(6,583,061)
11	(78,665,690)	64,554,382	(14,111,308)	19,468,574	(738,021)	(414,872)	(15,733,138)	10,085,682	1,837,071	(1,294,566)	(6,257,845)
12	(62,932,552)	51,643,506	(11,289,047)	19,468,574	(590,417)	(331,898)	(15,733,138)	10,165,161	1,852,229	(1,294,566)	(5,932,629)
13	(47,199,414)	38,732,629	(8,466,785)	19,468,574	(442,813)	(248,923)	(15,733,138)	10,244,640	1,867,387	(1,294,566)	(5,607,413)
14	(31,466,276)	25,821,753	(5,644,523)	19,468,574	(295,209)	(165,949)	(15,733,138)	10,324,120	1,882,545	(1,294,566)	(5,282,197)
15	(15,733,138)	12,910,876	(2,822,262)	19,468,574	(147,604)	(82,974)	(15,733,138)	10,403,599	1,897,703	(1,294,566)	(4,956,981)
16	(0)	(0)	(0)		(0)	(0)		(0)	(0)		(0)
Total					(17,712,514)	(9,956,939)	(235,997,071)	147,708,664	26,873,968	(19,418,492)	(108,502,384)

	A	B	C
1	Public Service Company of New Mexico		PNM Exhibit MFH-16
2	Tax Rate Differential on PVNGS Sale Leasebacks		Page 3 of 3
3	NMPPRC Case No. 16-00276-UT		
4			
5			
6	Taxable Gain for book purposes	528,025,676	
7			
8	State Income Tax at 6.2573%	33,040,275	Rate on pre-tax income = 6.675%/(1+6.675%)
9	Federal Income Tax at 35%	173,244,890	
10	Total Tax at Test Period Rates	206,285,166	
11			
12	Total Income Tax on Sale/Leaseback	193,663,146	
13			
14	Difference due to change in tax rates	(12,622,020)	
15			
16	Rate Differential Amortized over 15 years	(841,468)	
17			
18	Amortization of Rate Differential, grossed up at 35%	(1,294,566)	Line 14/(1-35%)

Estimated Excess Deferred State Income Taxes

PNM Exhibit MFH-17

Is contained in the following 1 page

	A	B	C	D	E	F	G	H	I	J
1	Public Service Company of New Mexico									PNM Exhibit MFH-17
2	Estimated Excess Deferred State Income Taxes									Page 1 of 1
3	NMPRC Case No. 16-00276-UT									
4										
5	ADIT Included in Rate Base	12/31/2013	2014 Activity	12/31/2014	2015 Activity	12/31/2015	2016 Activity	12/31/2016	2017 Activity	12/31/2017
6										
7	Federal ADIT	(571,223,718)	(42,287,779)	(613,511,497)	(56,606,473)	(670,117,970)	(54,752,172)	(724,870,142)	(62,860,342)	(787,730,484)
8	State ADIT	(92,491,342)	(13,150,838)	(105,642,180)	(16,383,475)	(122,025,655)	(11,846,411)	(133,872,066)	(10,868,041)	(144,740,106)
9	Total ADIT	(663,715,060)	(55,438,617)	(719,153,677)	(72,989,948)	(792,143,625)	(66,598,583)	(858,742,207)	(73,728,383)	(932,470,590)
10										
11	State ADIT	(92,491,342)	(13,150,838)		(16,383,475)		(11,846,411)		(10,868,041)	
12	Recorded at State Statutory Rate	7.06%	6.80%		6.45%		6.19%		5.84%	
13	Adjusted to 2018 Rate	5.57%	5.57%		5.57%		5.57%		5.57%	
14	Restated State ADIT	(72,971,215)	(10,772,083)		(14,148,210)		(10,659,856)		(10,365,580)	
15	Adjustment to State ADIT	19,520,127	2,378,754	21,898,882	2,235,265	24,134,147	1,186,555	25,320,702	502,461	25,823,162
16	Adjustment to Federal ADIT at 35%	(6,832,045)	(832,564)	(7,664,609)	(782,343)	(8,446,951)	(415,294)	(8,862,246)	(175,861)	(9,038,107)
17	Total Adjustment to ADIT	12,688,083	1,546,190	14,234,273	1,452,922	15,687,195	771,261	16,458,456	326,600	16,785,056
18										
19	Amortization over 20 years									
20										
21	State ADIT Amortization (included in tax expense)									(1,291,158)
22	Federal ADIT Adjustment									451,905
23	Total ADIT Adjustment									(839,253)
24										
25	Reverse South Georgia Method									
26										
27	Net Test Period Plant Assets in Rate Base									3,212,932,622
28	Book Test Period Depreciation Expense									153,053,135
29	Amortization Period (20 years used)									20.99

BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

IN THE MATTER OF THE APPLICATION)
OF PUBLIC SERVICE COMPANY OF NEW)
MEXICO FOR REVISION OF ITS RETAIL)
ELECTRIC RATES PURSUANT TO ADVICE)
NOTICE NO. 533)

Case No. 16-00276-UT

PUBLIC SERVICE COMPANY OF NEW)
MEXICO,)

Applicant)

AFFIDAVIT

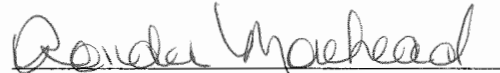
STATE OF NEW MEXICO)
) ss
COUNTY OF BERNALILLO)

MATTHEW F. HARLAND, Director of Income Tax for PNM Resources, Inc. and its subsidiaries including Public Service Company of New Mexico, upon being duly sworn according to law, under oath, deposes and states: I have read the foregoing **Direct Testimony of Matthew F. Harland** and it is true and accurate based on my own personal knowledge and belief.

SIGNED this 28 day of November, 2016.


MATTHEW F. HARLAND

SUBSCRIBED AND SWORN to before me this 28th day of November, 2016.


NOTARY PUBLIC IN AND FOR
THE STATE OF NEW MEXICO

