Resolution Regarding Appropriate Treatment of Excess Deferred Taxes And Unamortized Investment Tax Credits When a Utility Sells, Transfers, or Otherwise Deregulates Its Assets

---

WHEREAS, The treatment of excess deferred taxes (EDITs) and unamortized, un-recaptured investment tax credit balances (ITCs) related to assets that are sold, transferred, or deregulated is an issue of national importance as utility industries restructure and enter or contemplate competition; and

WHEREAS, EDITs and ITCs represent amounts paid by ratepayers through cost of service regulation; and

WHEREAS, EDITs arise when the federal tax rate is lowered and in such instances, deferred taxes above those required become excess. This results in an overpayment of taxes by ratepayers; and

WHEREAS, Section 203 of the Internal Revenue Code (IRC) requires that excess deferred taxes be passed back to ratepayers over the remaining life of the related assets. Therefore, the IRC contemplates that EDITs be returned to ratepayers; and

WHEREAS, Unlike the normal provision for deferred taxes which become due at the time an asset is sold, EDITs remain with the utility and unless recognized in ratemaking or stranded cost recovery, become an unwarranted windfall to the utility; and

WHEREAS, ITCs are grants from the federal government and serve to reduce the cost basis of the related asset. However, the IRC prohibits immediate flow thru of this tax benefit to ratepayers. Therefore, ratepayers provide funding for taxes greater than the actual tax obligation of the utilities and this amount is returned to ratepayers over the life of the related assets. The unamortized ITCs represent that portion of ratepayer funds to utilities that have not been returned; and

WHEREAS, An unwarranted windfall to the utilities would result if the unamortized ITCs are not returned to ratepayers in some manner since they represent funding for taxes not paid; and

WHEREAS, The Internal Revenue Service (IRS) stated in a letter ruling affecting Central Maine Power that when assets were sold or otherwise removed from regulation, the EDITs and ITCs no longer exist and could not be used in setting rates based on cost of service; and

WHEREAS, The Connecticut and New York commissions have also required utilities under their jurisdiction to request an IRS private letter ruling on this subject; and

WHEREAS, The NARUC at its 111th Annual Convention in San Antonio, Texas, requested that the Secretary of the Treasury provide regulations concerning the ratemaking treatment for EDITs and ITCs in cases where utility assets are sold or divested; *now therefore be it*

RESOLVED, That the Board of Directors of the National Association of Regulatory Utility Commissioners (NARUC) convened in its March 2000 Winter Meeting in Washington, D.C., requests that the Secretary of the Treasury provide directions that allow State regulators to consider EDITs and unamortized ITCs in any determination of the effect of restructuring upon ratepayers. This includes but is not limited to stranded cost/benefit recovery mechanisms.

Sponsored by the Committee on Finance and Technology
Adopted by the NARUC Board of Directors, March 8, 2000.