

WC-1 Resolution Urging Congress to Not Restrict the Right of State Regulators to Determine How Reductions in the Corporate Income Tax Rate are Addressed in Utility Rates

Whereas on September 27, 2017, the Trump Administration announced several proposed changes to the tax code. For public utility customers, the most consequential is the administration's proposal to reduce the corporate income tax rate from 35% to 20%;

Whereas Congress has also stated its intention to make changes to the tax code and has also proposed reductions in the corporate income tax rate;

Whereas for a State-regulated investor owned utility, a reduction in the corporate income tax rate should result in a direct benefit to customers, so long as it is captured in the State ratemaking process;

Whereas other federal tax policies, such as bonus tax depreciation, have allowed utilities to claim accelerated expenses associated with capital investments which reduce the taxes payable in the year when the deduction is claimed;

Whereas despite the reduction in taxes paid in a given year by a regulated investor owned utility, the rates which customers pay are conventionally designed to recover the statutory corporate income tax rate, and not the taxes actually paid by the utility reflecting such deductions;

Whereas this difference between tax expense paid by consumers in utility rates and taxes actually paid by a utility will increase the cash flow available to a utility's management in a year when such deductions are claimed. This additional tax benefit is accounted for as a deferred tax reserve and is conventionally treated similarly to customer-contributed capital, reducing the amount of rate base that is accounted for as having been contributed by equity and debt investors;

Whereas a process of normalization will refund to consumers this tax benefit over the lifespan of a given capital asset that has given rise to the deduction. The use of normalization by States is generally required by §168 of the Internal Revenue Code as a precondition of a regulated investor owned utility's ability to claim certain deductions;

Whereas if the corporate income tax rate is reduced from 35% to a lower rate, this lower rate will increase the deferred tax reserve that should be refunded to customers, because some utility income that will be subject to this lower tax rate has already had its associated tax expense paid for by customers, and at the higher, 35% tax rate. This incremental benefit is known as an excess tax reserve;

Whereas current drafts of the tax reform legislation being considered in Congress include language which requires States to normalize the excess tax reserve and would pre-empt States' ability to elect a rate treatment of their own choosing to either normalize, flow-through, or take some intermediate approach to refunding the excess tax reserve. This pre-emption reconstitutes a policy enacted by Congress when it last changed the corporate income tax rate in 1986;

Whereas Internal Revenue Code, §162, permits flexibility to regulated investor owned utilities, subject to State regulation, to elect either to flow-through or to normalize a similar type of tax benefit associated with the expensing of repairs to capital property;

Whereas federal tax legislation is not an appropriate vehicle to include language pre-empting States from exercising their traditional ratemaking authority;

Whereas the use of normalization spreads the distribution of the excess tax revenue to both current and future customers, all of whom will help pay off the cost of long-lived assets to benefit customers; and

Whereas while normalization is one potential treatment of the excess tax reserve, the appropriate treatment may depend on local considerations and should rest with the State, exercising its authority to set retail rates for a regulated investor owned utility; *now, therefore be it*

Resolved that the National Association of Regulatory Utility Commissioners, convened at its Annual Meeting and Education Conference in Baltimore, Maryland, urges Congress to refrain from inserting any language into any revision of the federal tax law that will restrict the jurisdiction of the State public utility commissions over utility rates or specify how State commissions may reflect changes in tax expense in the retail ratemaking process.

Sponsored by the Committee on Water

Recommended by the NARUC Board of Directors November 14, 2017

Adopted by the NARUC Committee of the Whole November 15, 2017