



IRS Private Letter Ruling on Cost of Removal

Implications and actions for energy companies to consider now

On August 14, 2020, the IRS issued PLR 202033002. This private letter ruled that the taxpayer's electric and gas Cost of Removal ("COR") related net deferred tax assets and liabilities are not protected by the normalization rules. As with any ruling of this type, it has taken time for the industry to understand and absorb the ruling and its many impacts. Some utilities moved to act on the ruling immediately, while others have taken more of a watch-and-see approach.

Regardless of where you may be on the continuum, we know that many companies continue to wrestle with the best way to operationalize the requirements of the ruling.

What the ruling means for you now

We first contacted PowerPlan clients about this ruling in 2020, when it was issued initially. We have since been monitoring its evolution. With the latest release of PLR 202230005 in July 2022 once more confirming that normalization rules do not apply to COR, we believe it's now critical to draw your attention back to the ruling, as **it may have various impacts your company, depending upon your deferred tax setup in PowerTax.**

While PLRs are by their nature only applicable to the requesting taxpayer (the IRS indicates in each PLR that "This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent."), the ruling is something we are watching closely on behalf of our clients. **Should the Internal Revenue Service decide to redact the taxpayer information and issue a Revenue Ruling on the content, it would result in new formal guidance for applicable taxpayers.**

Background on COR accounting for regulated entities

Many regulated utilities develop book depreciation rates which include a life component and COR component. For book purposes, COR depreciation expense is recognized over the life of an asset (as a debit) and builds up an accumulated reserve for depreciation which is a credit balance. The COR portion of the reserve for depreciation reverses when the COR expenditures take place at the end of the asset's life. Note that GAAP (generally accepted accounting principles) require that the COR accumulated reserve to be reclassified to a regulatory liability. Accordingly, most of our clients separately track COR accumulated reserve within their PowerPlan assets/depreciation system for book purposes.

For tax purposes, COR is deductible when ultimately paid. As stated in the PLR: "While COR may be a component of the calculation of the amount treated as book depreciation, it is a deduction under § 162 and has nothing to do with actual accelerated tax depreciation."

PowerTax COR Configuration

PowerTax treats the overall difference between book and tax depreciation as a “protected” method/life temporary difference. For most of our customers, COR was not identified in the PowerTax system as a separate temporary difference, and instead is a part of the total amount of book depreciation. **In these situations, if this PLR becomes a Revenue Ruling, it will be necessary to perform an analysis of the book COR Reserve amounts to vintage the amounts and carve them out of the existing PowerTax property-related temporary differences.** The ease or complexity of this task will depend greatly on the detail available on the book side with respect to the COR reserve. Once the book COR reserve is “vintaged,” the COR ADIT (Accumulated Deferred Income Taxes) can be established for the new temporary difference by applying the appropriate tax rates.

Impact of COR ADIT Change

As this ruling highlights, care should be taken in considering what portion of the fixed asset deferred tax liabilities are considered subject to the normalization rules. This consideration directly applies to those utilities still negotiating with public commissions about giving back excess deferred taxes, as well as settlements that have already occurred. Among the impacts:

- For most of your organizations, it would **increase the protected excess deferred tax liability because it is no longer offset by the unprotected COR excess debit balance.**
- This will also impact excess deferred taxes reversed over ARAM (Average Rate Assumption Method).
- The new unprotected COR temporary difference will automatically reverse as cost of removal expense is incurred.
- It will create new COR unprotected excess debit amounts.

If you have not yet done so, we urge you to discuss this matter with your regulatory commission(s), tax advisors and auditors to ensure you have approval and buy-in on the appropriate excess reversal method.

We're here to help

We understand this ruling could create potential complexities for you if it comes to fruition. We have talked with numerous clients about this topic, and we're here to help you respond with clarity and confidence. If you have questions or concerns, we welcome the opportunity to offer guidance based on your specific circumstances. Please email taxreform@powerplan.com to schedule a discussion with our tax experts. In the meantime, be sure to keep an eye on your inbox as we continue to develop more detailed insight on this topic for you in the weeks ahead.



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