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March 9, 2018

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

**VIA ELECTRONIC FILING**

**RE: Tax Cuts and Jobs Act of 2017; Docket No. M-2018-2641242**

Dear Secretary Chiavetta:

Please find enclosed for filing with the Pennsylvania Public Utility Commission the Comments of the Pennsylvania Energy Consumer Alliance, PP&L Industrial Customer Alliance, the Met-Ed Industrial Users Group, the Philadelphia Area Industrial Energy Users Group, the Penelec Industrial Customer Alliance, the West Penn Power Industrial Intervenors, the Philadelphia Industrial and Commercial Gas Users Group, and the Columbia Industrial Intervenors in the above referenced proceeding.

Thank you.

Very truly yours,

McNEES WALLACE & NURICK LLC

By Susan E. Bruce

Counsel to the Pennsylvania Energy Consumer Alliance, PP&L Industrial Customer Alliance, the Met-Ed Industrial Users Group, the Philadelphia Area Industrial Energy Users Group, the Penelec Industrial Customer Alliance, the West Penn Power Industrial Intervenors, the Philadelphia Industrial and Commercial Gas Users Group, and the Columbia Industrial Intervenors.

Enclosure

cc: Erin Laudenslager, Bureau of Technical Utility Services (via E-mail)
James Mullins, Esq. Law Bureau (via E-mail)

**BEFORE THE**
**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

| | | |
|---|---|---|
| Pennsylvania Public Utility Commission<br>Launches Investigation into the Effects<br>of the Tax Cuts and Jobs Act of 2017<br>on Pennsylvania Public Utilities | :<br>:<br>:<br>: | M-2018-2641242 |

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# COMMENTS OF THE PENNSYLVANIA ENERGY CONSUMER ALLIANCE, PP&L INDUSTRIAL CUSTOMER ALLIANCE, MET-ED INDUSTRIAL USERS GROUP, PHILADELPHIA AREA INDUSTRIAL ENERGY USERS GROUP, PENELEC INDUSTRIAL CUSTOMER ALLIANCE, WEST PENN POWER INDUSTRIAL INTERVENORS, PHILADELPHIA INDUSTRIAL AND COMMERCIAL GAS USERS GROUP, AND COLUMBIA INDUSTRIAL INTERVENORS

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Dated: March 9, 2018

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## I. INTRODUCTION

On January 1, 2018, the Tax Cuts and Jobs Act of 2017, Pub. L. 115-97, ("TCJA") took effect and made wholesale revisions to the Internal Revenue Code. One of the TCJA's most notable reforms is its reduction in the federal corporate income tax ("FIT") rate from 35% to 21%. This reduction may also impact state taxes. Under Chapter 61 of the Pennsylvania Code, "taxable income" is defined as "federal taxable income before net operating loss deduction and special deductions as returned to and ascertained by the Federal government[.]"[1] Thus, if implementation of the TCJA results in lower federal taxable income amounts for public utilities (*i.e.*, lower amounts upon which the 9.99% Pennsylvania Corporate Net Income ("CNI") tax rate is applied), utilities' annual state tax obligations will be reduced as well.

On February 12, 2018, the Pennsylvania Public Utility Commission ("PUC" or "Commission") initiated the above-docketed proceeding to review the effects of the TCJA on the tax liabilities of PUC-regulated public utilities for 2018 and future years and to evaluate the feasibility of reflecting such impacts in the rates charged to ratepayers.[2] As discussed further below, the PUC is interested in assessing the impact of the reduced FIT rate on utilities, the TCJA's effect on accumulated deferred income taxes ("ADITs") of PUC-regulated public utilities, and the manner in which the reduced annual tax obligations will be addressed in rates charged to Pennsylvania's public utilities' customers.

The Pennsylvania Energy Consumer Alliance, the PP&L Industrial Customer Alliance, the Met-Ed Industrial Users Group, the Philadelphia Area Industrial Energy Users Group, the Penelec Industrial Customer Alliance, the West Penn Power Industrial Intervenors, the Philadelphia Industrial and Commercial Gas Users Group, and the Columbia Industrial Intervenors (collectively, "Commercial and Industrial Users") commend the Commission for providing stakeholders with the opportunity to comment on this matter.

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[1] 66 Pa. Code § 153.11.

[2] Secretarial Letter, *Re: Tax Cuts and Jobs Act of 2017*, Docket No. M-2018-2641242 (Feb. 12, 2018).

As explained in further detail below, all customers should receive their fair share of the benefits of these tax changes. One way in which this can be accomplished is through reduced rates. Rate reductions are a clear means of ensuring that customers benefit from the lower FIT rate. Another way is by implementing a class-specific negative surcharge (or surcredit) to ensure that the monetary benefits are returned to customers.

In addition, due to the recalculation of ADIT balances at the 21% FIT rate, utilities may have excess deferred income taxes. Thus, the PUC should also consider how this excess amount will be returned to customers, and the proper method for doing so under the TCJA.

Further, Distribution System Improvement Charge ("DSIC") mechanisms and other automatic adjustment mechanisms will need to be revised to ensure that the prevailing tax rates are reflected since the TJCA's tax reforms took effect on January 1, 2018.

Finally, the Commission should order or otherwise ensure Electric Distribution Companies ("EDCs") that charge formula transmission rates make appropriate reductions at the Federal Energy Regulatory Commission ("FERC") to ensure that the TJCA impacts flow through to default service customers. This will ensure that the retail transmission rates charged to default service customers through PUC-regulated mechanisms like a Transmission Service Charge ("TSC") are just and reasonable, while also having the residual effect of ensuring that the adjustments occur for shopping customers. This parallel adjustment between the TSC and the FERC transmission rates is necessary to ensure that shopping decisions are not detrimentally impacted by having disparate transmission rates based on whether the account is on default service or is shopping.

In summary, the PUC should ensure that a thorough analysis of these tax changes is performed to ensure that each customer class receives its appropriate share of any refund or reduction.

## II. COMMENTS

### *A. Impacts of the TCJA on Tax Calculations Affecting Public Utilities*

The TCJA has several critical impacts on tax calculations affecting public utilities. First, as of January 1, 2018, the tax rate change in the TCJA reduces the FIT rate from 35% to a flat 21% rate.

Second, the reduction in the tax rate affects the level of ADIT liabilities and assets that public utilities recognize. This effect is relevant because utility-related ADIT liabilities are typically treated as rate base reductions for ratemaking purposes, and ADIT assets may be treated as additions to the rate base.

Third, utilities may have excess deferred income taxes because of the reduction in the FIT rate, as the ADIT assets and liabilities that were established at the 35% tax rate must be reduced to reflect the fact that the ADIT balances must be restated based upon the 21% tax rate. The difference between the ADIT amounts calculated at 35% and 21% are the excess deferred income taxes.

A brief explanation of the source of many ADIT balances demonstrates why the second and third items (ADIT and excess deferred taxes) need to be examined. Tax laws permit accelerated depreciation rates for certain assets. For example, for FIT purposes, a public utility may have assets that can use accelerated depreciation, but for ratemaking purposes, that utility uses straight-line depreciation. Accordingly, for a new asset, the permitted tax return depreciation expense may initially exceed the permitted ratemaking depreciation expense. The difference between the FIT depreciation expense and the ratemaking depreciation expense, referred to as a "timing difference," in this instance will generate an ADIT liability, which is equal to the timing difference times the tax rate. Those ADIT liabilities are later reversed as ratemaking depreciation expense exceeds the asset's tax return depreciation expense. The ADIT liability amount is a "snapshot in time" difference between FIT depreciation expense and the depreciation expense typically used to calculate the utility's revenue requirement. With accelerated depreciation, the depreciation-related tax expense is front-loaded and decreases during the asset's depreciable life.

Before the TCJA took effect, deferred tax assets and liabilities identified due to timing differences were calculated using the prior tax rates. However, now that the TCJA has taken effect, the amounts of the deferred assets and liabilities warrant adjustment because of the change in the FIT rate. If the tax rate falls, as it has with implementation of the TCJA, then ADIT liabilities should be reduced, which would result in excess deferred income taxes. To amortize the excess deferred income tax amount, the Commission may direct the public utility to identify the excess amount and then amortize it over some period. Additionally, the PUC may adjust the public utility's rate base to account for the change in the deferred tax liability.

Federal law does not require the sharing of excess deferred income taxes with customers, but if the PUC orders such sharing in order to ensure that rates remain just and reasonable as required by Section 1301 of the Public Utility Code, 66 Pa. C.S. § 1301, those changes in the amortization of the excess could be accomplished in several ways. The TCJA, however, prescribes that the excess deferred income taxes associated with depreciation must be normalized into customer rates in a highly prescribed manner.[3] These are known as "protected" excess deferred income taxes. More specifically, the excess deferred income taxes as of December 31, 2017, related to depreciation may be shared with customers in one of two methods. Under one method (the Average Rate Assumption Method), the amount cannot be returned any faster than the remaining regulatory life of the asset that prompted the creation of the excess deferred taxes. Under the alternative method, the utility would amortize the excess amount over the remaining life of all public utility property included in the plant account or a composite rate used to compute depreciation. In summary, the lower tax rate must be recognized and adjusted, for purposes of computing a revenue requirement. Furthermore, rider-specific revenue requirements that are grossed up for taxes or are subject to carrying charges that include a component for FIT expense must also be adjusted for the lower tax rate.

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[3] *See* TCJA Subtitle C, Part I, Sec. 13001(d)(3)(B).

Some utilities may also have other ADIT assets and liabilities that will generate excess deferred taxes; however, these ADIT assets and liabilities are not related to depreciation expense differences. The excess deferred income taxes associated with these items are known as "unprotected" excess deferred income taxes. The PUC has some discretion to determine how and when to use the unprotected excess deferred income taxes and could exercise its discretion to help mitigate future rate impacts to customers by ordering a shorter amortization period. *See, e.g., Pennsylvania Public Utility Commission v. Philadelphia Electric Company*, 1990 Pa. PUC LEXIS 155, *275-283 (May 16, 1990) (PUC Order acknowledging that "The Internal Revenue Code permits the excess deferred federal income taxes associated with these 'unprotected' normalization items to be flowed back more rapidly than over the average remaining life of the asset to which they relate" and holding that "Amortizing the entire $29.939 million excess deferred tax balances over [a] five-year period recommended by the [Administrative Law Judges] would serve the public interest in ensuring that the ratepayers who provided those tax benefits will have the maximum opportunity of recovering these benefits through lower rates").

*B. Recommendation*

The Commonwealth recognizes the significant impact that taxes have upon utilities' ratemaking processes and has a history of taking action to ensure that rates are just, reasonable, and nondiscriminatory. *See, e.g.,* Act 40 of 2016 (establishing 66 Pa. C.S. § 1301.1 and eliminating the consolidated tax adjustment when setting rates).[4] Here, to acknowledge the positive effects that the TCJA should have on the rates that customers pay for price-regulated public utility services, the Commission should take immediate steps to ensure that each customer class receives a rate reduction or surcredit to reflect the benefits of the TCJA.

[4] Act 40 of 2016 reflects the perspectives of the Pennsylvania legislature and several other states and the federal government that the proper way to calculate a utility's FIT expense is based upon its own operations, and not those of an unregulated affiliate.

First, the Commission should begin incorporating the tax reduction into rates and riders that contain adjustments for FIT (including riders that recover costs of providing a service but which are grossed up for taxes). For example, most riders, like the DSIC, are updated on at least a quarterly basis and therefore lend themselves to being updated for the reduced tax rate. The Commission should also use open proceedings to incorporate the change in the FIT rate into tariffed rates.

Second, each public utility should calculate a rate reduction or surcredit for each customer class (including each service schedule or rate schedule, where necessary) to flow through the reduction in tax payments in comparison to that assumed at the higher tax rate in its most recent rate case. This modification should start immediately and be retroactive to January 1, 2018, the effective date of the tax change.

Third, regarding excess deferred income taxes, the PUC should require public utilities to share the excess deferred income taxes with customers. For any portion of excess deferred income taxes not related to depreciation, the Commission should order a more expedited amortization period.

Fourth, as previously discussed, the Commission should order EDCs that have FERC transmission rates to implement appropriate adjustments consistent with the adjustments discussed above to reflect the impact of the TJCA. This will ensure that the retail transmission rates charged to default service customers and the transmission rates charged to shopping customers are adjusted appropriately and remain just and reasonable.

## III. CONCLUSION

**WHEREFORE**, the Pennsylvania Energy Consumer Alliance, the PP&L Industrial Customer Alliance, the Met-Ed Industrial Users Group, the Philadelphia Area Industrial Energy Users Group, the Penelec Industrial Customer Alliance, the West Penn Power Industrial Intervenors, the Philadelphia Industrial and Commercial Gas Users Group, and the Columbia Industrial Intervenors respectfully request the Pennsylvania Public Utility Commission consider these Comments in evaluating: (1)

whether the PUC should adjust current customer rates to reflect the reduced annual state and Federal Income Tax expenses of public utilities due to the tax rate changes in the Tax Costs and Adjustments Act; (2) the appropriate negative surcharge or other methodologies that would permit immediate modifications to consumer rates; and (3) whether the surcharge or other methodology should provide that any refunds to customers due to these reduced taxes be effective as of January 1, 2018.

Respectfully submitted,

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