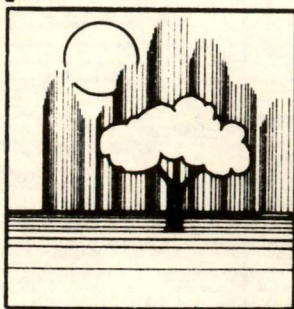


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ELECTRIC UTILITY PHANTOM TAXES 1982



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724 Dupont Circle Building
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ELECTRIC UTILITY PHANTOM TAXES: 1982

Electric utility companies billed their customers for over \$5 billion in 1982 federal income taxes which they were not required to pay to the government. These tax overcharges, or "phantom taxes," are permitted under a provision of the federal tax code which requires utilities to charge customers as if they did not receive certain major tax benefits.

Phantom taxes have clearly reached epidemic proportions in the electric utility industry. Nationwide, the power companies are now holding approximately \$34 billion in unpaid federal income taxes which they have collected since this practice began in 1954--the equivalent of over \$400 per U.S. household.

1982 Findings

Environmental Action Foundation surveyed federal income tax expense data contained in Form 1 annual reports filed by individual power companies with the Federal Energy Regulatory Commission. The survey covered the nation's 150 largest investor-owned electric utilities which provide service to residential consumers.

According to the Form 1 reports, the 150 power firms owed the Internal Revenue Service (IRS) \$2.0 billion for 1982 federal income taxes. However, these same utilities reported a total federal income tax expense of \$7.1 billion, which is the amount they are permitted to charge customers. Thus, electricity consumers were billed for \$5.1 billion in 1982 federal income taxes which their utilities were not required to pay to the IRS.

The largest phantom tax charge in 1982 was by Commonwealth Edison Co., which overcharged its customers for federal income taxes by more than a quarter of a billion dollars. The Chicago-based utility billed ratepayers for \$278 million in 1982 federal income taxes, even though it reported a tax liability of only \$17 million. The resulting overcharge was \$261 million. The next largest tax overcharges were by Houston Lighting & Power Co. (\$234 million), Duke Power Co. (\$184 million), and Georgia Power Co. (\$183 million).

Of the 150 utilities surveyed, 29 reported no federal income tax liability for 1982. Twenty-eight of these companies claimed tax refunds from IRS totaling \$248 million. Yet these same companies charged their customers as if they had paid \$1.2 billion in federal income taxes. The largest refund was claimed by Tucson Electric Power Co.: \$35 million. Yet Tucson Electric charged its ratepayers as if it had paid \$23 million in federal income taxes.

Residential customers of the 150 utilities surveyed paid, on the average, \$21.45 in higher annual electric bills because of phantom taxes. On a per-customer basis, the largest tax overcharge in 1982 was \$91.54 by Tucson Electric. Other utilities whose ratepayers bore the greatest phantom tax burden in 1982 were Houston Lighting & Power Co. (\$70.50), Public Service Co. of Indiana (\$70.25), and Idaho Power Co. (\$67.65).

Higher electric bills are only a part of the burden borne by consumers for phantom taxes. Commercial and industrial customers must also pay phantom taxes in their electric bills, and they pass on these charges to consumers through higher prices for goods and services. The total cost of phantom taxes to consumers is nearly three times the amount they pay in their electric bills. Altogether, electric utility phantom taxes in 1982 cost the average U.S. household \$60.91.

How Phantom Taxes Arise

Like other businesses, utilities receive substantial federal tax benefits when they make new investments. Three such benefits, accelerated depreciation, shortened tax lives, and the investment tax credit (ITC), save electric utilities billions of dollars annually on their tax returns. As a result, many utilities pay little or no income tax to the Internal Revenue Service. Most of the phantom taxes charged by utility companies are related to these three federal tax breaks.

Phantom taxes are created by an accounting device known as normalization. Under this procedure, the tax benefits a utility receives when it builds a new power plant are not used to lower current rates to consumers. Instead, these tax savings are passed through to ratepayers gradually as the investment is depreciated. Consumers and many regulators prefer an alternative known as flow-through accounting, whereby a utility passes its tax savings on to consumers immediately. Flow through of major utility tax benefits, however, is not permitted by federal law.

Through the investment tax credit, the federal government offers utilities a tax break equivalent to 10 percent of the cost of investments in new machinery such as power plants. A utility normalizes its ITC benefits by charging its customers for tax expenses as if there were no tax credit. The utility places these unpaid taxes, called deferred ITCs, in a special account. These deferred investment credits are refunded to ratepayers over the life of the plant, a process which may take 40 years. By the time these refunds take place, however, they are usually more than offset by new ITC charges.

Accelerated depreciation and shortened tax lives allow a utility to postpone the payment of a portion of its tax liability. The utility normalizes these benefits by charging customers as if it paid these taxes currently. The extra "taxes" it collects, called deferred taxes, are placed in a deferred tax account. Gradually, over a period of about 30 years, these taxes come due at the IRS. But by the time the utility gets around to paying those taxes, it usually has new tax breaks to offset them. The money in these deferred tax and deferred ITC accounts is available for investment in new assets such as power plants.

In 1954, when accelerated depreciation was first allowed, many state utility commissions chose to use flow-through accounting of these benefits, thus preventing tax overcharges. Under pressure from utility lobbyists, Congress in 1969 mandated normalization of accelerated depreciation benefits for most utilities. In 1971, a similar clause was added to the tax code requiring normalization of ITC benefits. Some utilities already using flow-through accounting were exempted from these requirements through a "grandfather" clause. The passage of the Economic Recov-

ery Tax Act of 1981 extended mandatory normalization treatment to all utilities for new investments.

How Phantom Taxes Accumulate

With the power industry collecting billions of dollars in phantom taxes annually, the money contained in their deferred tax accounts is skyrocketing. At the end of 1982, the 150 utilities surveyed were holding \$19 billion in accumulated deferred taxes and \$10.4 billion in accumulated deferred ITC's--a total of \$29.4 billion. According to EEI, these accounts now contain approximately \$34 billion. That is equivalent to \$405 for every household in the United States.

Commonwealth Edison Co. alone had nearly \$1.6 billion in its deferred tax accounts at the end of 1982. Two other utilities, Florida Power & Light Co. and Georgia Power Co., were each holding over \$1 billion in unpaid taxes in these accounts.

Of the \$29.4 billion in the power companies' deferred tax accounts in 1982, approximately 35 percent came from residential electricity customers, with the balance coming mainly from commercial and industrial customers. Looking at the residential class alone, the 150 utilities surveyed have accumulated an average of \$135 per customer. The utility with the largest accumulated deferred taxes and tax credits per residential customer in 1982 was Public Service Co. of Indiana, with \$417. It was followed by Carolina Power & Light Co. (\$338) and Gulf Power Co. (\$322).

Utilities insist that eventually all of their deferred taxes will be paid to the government, but the industry's own figures demonstrate that this is not the case. Edison Electric Institute (EEI), the power industry's trade association, points out that "In 1981, \$2.5 billion of deferred taxes were paid to the Treasury by investor-owned electric utilities." Indeed, \$2.5 billion in electric utility deferred taxes came due in 1981, but the U.S. Treasury never received anything near that amount. The power industry's entire tax liability for 1981 was only \$1.3 billion. New tax deferrals more than offset the deferred taxes from prior years which came due. As long as utilities continue growing and building new plants, they can postpone paying their deferred taxes indefinitely.

How Phantom Taxes Increase Utility Profits

One provision of the federal tax code allows utilities to earn a profit from some of their unpaid taxes. When a utility receives a 10 percent investment credit for a new power plant, it collects enough deferred ITCs from its ratepayers to pay for 10 percent of the cost of the plant. The federal law allows a utility to earn a profit on the entire investment, even though consumers financed one-tenth of the plant's cost.

Many economists and regulators feel that utilities should not earn a return on the portion of an investment financed by ratepayers through deferred ITC's. Even regulators who do not favor immediate flow-through of tax benefits to customers, often favor a procedure called economic normalization, whereby deferred taxes and investment credits are de-

✓ ducted from the utility's rate base until they are either paid to the government or returned to ratepayers. This procedure compensates ratepayers for the involuntary loans they must make to the utility.

Utility regulators routinely use economic normalization for deferred taxes, but federal law prohibits its use for deferred ITCs. The federal law states that regulators should not consider the added profits from the ITC when setting a utility's rates. Extra profits from deferred investment credits totaled approximately \$1.1 billion for the power industry in 1982, and they are expected to reach \$3 billion annually by the 1990s.

How Phantom Taxes Encourage Unwise Investments

When the law requiring utilities to collect phantom taxes was first conceived in 1969, it was intended to help growing utilities finance the construction of new facilities. Today this law encourages utilities to overbuild and contributes to the power industry's serious problem of excess generating capacity.

The faster a utility grows, the more phantom taxes it can collect. And as long as a utility keeps growing, it can continue to postpone paying most or all of its federal income taxes. This powerful growth incentive encourages utilities to rely on costly centralized generating technologies and discourages them from pursuing energy conservation and alternative energy strategies.

Because of growth incentives such as phantom taxes, the power companies have pursued a course of expansion which far exceeds the growth in demand for electric power. In the past few years, over \$10 billion in utility construction projects have been abandoned, and the burden of these cancellations will be borne by the nation's ratepayers, taxpayers, and utility shareholders. Many of these projects might never have been started without the financial boost afforded by phantom taxes.

Conclusion

Electric utility phantom tax charges are now over \$5 billion per year and they have been increasing by about \$1 billion annually. Besides burdening consumers, phantom taxes encourage poor planning and unwise investments by utilities. These tax overcharges are likely to continue to grow as long as state utility commissions are prevented from exercising jurisdiction over federal income tax expenses.

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Research assistant: Joseph A. McNamara

TOP TEN PHANTOM TAX RANKINGS, 1982

Phantom Taxes (millions)

1. Commonwealth Edison Co.(Il)	\$261
2. Houston Lighting & Power Co.(Tx)	234
3. Duke Power Co.(NC,SC)	184
4. Georgia Power Co.(Ga)	183
5. Alabama Power Co.(Al)	176
6. Pacific Gas & Electric Co.(Ca)	158
7. Philadelphia Electric Co.(Pa)	154
8. Virginia Electric & Power Co.(NC,Va,WV)	144
9. Public Service Electric & Gas Co.(NJ)	139
10. Northern States Power Co.(Mn,ND,SD)	127

Phantom Taxes Per Residential Customer

1. Tucson Electric Power Co.(Az)	\$91.54
2. Houston Lighting & Power Co.(Tx)	70.50
3. Public Service Co. of Indiana (In)	70.25
4. Idaho Power Co.(Id,Nv,Or)	67.65
5. Alabama Power Co.(Al)	65.63
6. Portland General Electric Co.(Or)	64.39
7. Otter Tail Power Co.(Mn,ND,SD)	60.98
8. Toledo Edison Co.(Oh)	56.14
9. Duke Power Co.(NC,SC)	53.16
10. Arizona Public Service Co.(Az)	52.07

Accumulated Deferred Taxes and Tax Credits (millions)

1. Commonwealth Edison Co.(Il)	\$1599
2. Florida Power & Light Co.(Fl)	1143
3. Georgia Power Co.(Ga)	1097
4. Public Service Electric & Gas Co.(NJ)	944
5. Duke Power Co.(NC,SC)	913
6. Carolina Power & Light Co.(NC,SC)	721
7. Consumers Power Co.(Mi)	711
8. Houston Lighting & Power Co.(Tx)	711
9. Alabama Power Co.(Al)	706
10. Detroit Edison Co.(Mi)	662

Accumulated Deferred Taxes and Tax Credits Per Residential Customer

1. Public Service Co. of Indiana (In)	\$417.13
2. Carolina Power & Light Co.(NC,SC)	338.40
3. Gulf Power Co.(Fl)	321.77
4. Florida Power & Light Co.(Fl)	289.06
5. Tampa Electric Co.(Fl)	288.50
6. Florida Power Corp.(Fl)	286.21
7. Tucson Electric Power Co.(Az)	283.23
8. Otter Tail Power Co.(Mn,ND,SD)	266.91
9. Alabama Power Co.(Al)	263.91
10. Duke Power Co.(NC,SC)	263.44

UTILITY^a

UTILITY ^a	SIZE OF COMPANY (RANKED BY KWH SALES)	FEDERAL INCOME TAXES CHARGED TO CUSTOMERS ^b	REPORTED FEDERAL INCOME TAX OWED TO GOVERNMENT ^c	1982 PHANTOM TAXES ^d		1982 PHANTOM TAXES PER RESIDENTIAL CUSTOMER ^e		ACCUMULATED DEFERRED TAXES & TAX CREDITS ^f		ACCUMULATED DEFERRED TAXES & TAX CREDITS PER RESIDENTIAL CUSTOMER ^e	
		(\$)	(\$)	(\$)	RANK	(\$)	RANK	(\$)	RANK	(\$)	RANK
Alabama Pwr Co (Al)	9	157956868	-17675554	175632422	5	65.63	5	706181593	9	263.91	9
Appalachian Pwr Co (Va,WV)	17	48064662	649134	47415528	37	21.56	73	152189748	61	69.21	107
Arizona Public Serv Co (Az)	51	76577434	4761187	71816247	23	52.07	10	93742745	84	67.97	110
Arkansas Pwr & Lt Co (Ar,Mo)	27	60491232	3461032	57030200	28	35.19	32	342899189	23	211.63	25
Atlantic City Elec Co (NJ)	92	13063984	10190964	2873020	114	4.17	123	123083149	72	178.66	41
Baltimore Gas & Elec Co (Md)	34	95953936	34727959	61225977	25	20.45	75	317365804	25	106.02	88
Bangor Hydro-Electric Co (Me)	128	753722	-748350	1502072	119	8.56	109	6845057	140	39.04	139
Black Hills Pwr & Lt Co (SD,Mt,Wy)	129	4244539	3930000	314539	133	2.58	128	24491510	122	201.38	33
Blackstone Valley Elec Co (RI)	131	673097	844693	-171595	141	-76	142	5228768	143	23.19	145
Boston Edison Co (Ma)	55	42854720	6912793	35941927	49	16.21	91	365801180	21	165.04	54
CP National Corp (Ca,Az,Nv,Or)	138	3447756	254401	3193355	112	11.74	101	15845812	130	58.29	117
Cambridge Elec Lt Co (Ma)	134	219988	-130788	350776	132	1.43	134	13487636	132	55.34	121
Carolina Pwr & Lt Co (NC,SC)	12	114570334	27967369	86602965	16	40.66	14	720672370	6	338.40	2
Centel Corp (Co,Ks)	114	4906877	-4192702	9099579	94	25.18	60	46511894	109	128.72	78
Central Hudson Gas & Elec Corp (NY)	96	17962700	4991470	12971230	84	17.99	83	38959116	114	54.04	124
Central Illinois Lt Co (Il)	101	34121516	20848900	13272616	83	17.63	84	185533100	48	246.52	14
Central Illinois Pub Serv Co (Il)	71	40284970	11161042	29123928	59	26.80	54	250204462	41	230.29	19
Central Louisiana Elec Co (La)	99	10160157	19938716	-9778558	149	-26.92	150	66283418	99	182.53	39
Central Maine Pwr Co (Me)	83	11461906	-506673	11968579	86	14.10	94	87463088	91	103.08	92
Central Pwr & Lt Co (Tx)	48	57039020	25061000	31978020	56	25.48	57	283087314	31	225.57	20
Central Vermont Pub Serv Corp (Vt)	118	9446923	12212493	-2765569	145	-10.73	149	17329908	126	67.26	112
Cincinnati Gas & Elec Co (Oh)	44	66869645	16284998	50584647	34	24.55	62	199942043	46	97.06	93
Citizens Utilities Co (Az,Hi,Id,Vt)	136	7054755	5071950	1982805	116	11.59	102	21474608	125	125.62	79
Cleveland Elec Illum Co (Oh)	39	85423422	12206741	73216681	22	35.86	29	333610378	24	163.43	57
Columbus & Southern Ohio El Co (Oh)	54	34358095	67522	34290573	52	28.29	51	114792670	75	94.73	94
Commonwealth Edison Co (Il)	3	277746805	16684152	261062653	1	31.96	41	1599136811	1	195.82	34
Commonwealth Elec Co (Ma)	117	5870931	5107707	763224	129	1.75	131	40652771	113	93.24	95
Connecticut Lt & Pwr Co (Ct)	40	81583428	3552084	78031344	20	33.44	39	149263347	63	63.97	113
Consolidated Edison Co of NY (NY)	13	260180000	216400000	43780000	39	4.22	122	630908000	11	60.88	114
Consolidated Water Pwr Co (Wi)	149	-149776	-193598	43822	138	1.22	135	303887	148	8.51	148
Consumers Pwr Co (Mi)	21	21852579	-11325599	33178178	54	4.89	119	710611022	7	104.80	90
Dallas Pwr & Lt Co (Tx)	53	41699340	17761525	23937815	63	34.50	35	150406021	62	216.77	22
Dayton Pwr & Lt Co (Oh)	66	53619600	2793400	50826200	33	38.24	18	137284600	67	103.30	91
Delmarva Pwr & Lt Co (De,Md,Va)	76	49048195	37172174	11876021	87	13.26	98	134709080	68	150.48	64
Detroit Edison Co (Mi)	10	96950940	2403259	94547681	11	18.60	80	661911656	10	130.22	75
Duke Pwr Co (NC,SC)	5	201761408	17452607	184308801	3	53.16	9	913353368	5	263.44	10
Duquesne Light Co (Pa)	61	61524303	10989400	50534903	35	32.08	40	304395655	26	193.24	38
Eastern Edison Co (Ma)	121	3874576	2426495	1448081	120	4.68	120	10551331	137	34.14	141
El Paso Elec Co (Tx,NM)	106	23803649	5095161	18708488	72	35.73	31	111923030	77	213.79	24
Empire District El Co (Ar,Ks,Mo,Ok)	115	8525999	4028000	4497999	108	19.71	77	33842704	118	148.33	68
Florida Pwr & Lt Co (Fl)	7	148670287	60086591	88583696	15	22.40	67	1143083101	2	289.06	4
Florida Pwr Corp (Fl)	32	46647375	11699230	34948145	51	20.80	74	480897855	16	286.21	6
Georgia Pwr Co (Ga)	6	154023070	-28838115	182861185	4	43.13	12	1097125227	3	258.77	12
Green Mountain Pwr Corp (Vt)	127	4131589	0	4131589	110	30.16	47	7587575	138	55.40	120
Gulf Power Co (Fl)	87	27586037	16549121	11036916	89	25.09	61	141536594	65	321.77	3

UTILITY ^a -----	SIZE OF COMPANY (RANKED BY KWH SALES) -----	FEDERAL INCOME TAXES CHARGED TO CUSTOMERS ^b	REPORTED FEDERAL INCOME TAX OWED TO GOVERNMENT ^c	1982 PHANTOM TAXES ^d		1982 PHANTOM TAXES PER RESIDENTIAL CUSTOMER ^e		ACCUMULATED DEFERRED TAXES & TAX CREDITS ^f		ACCUMULATED DEFERRED TAXES & TAX CREDITS PER RESIDENTIAL CUSTOMER ^e	
		(\$)	(\$)	(\$)	RANK	(\$)	RANK	(\$)	RANK	(\$)	RANK
Gulf States Utilities Co (La,Tx)	18	53778093	10034141	43743952	40	25.30	58	351537918	22	203.35	32
Hawaiian Elec Co (Hi)	95	12462573	17932588	-5470014	146	-8.16	148	103569850	81	154.55	62
Houston Lighting & Pwr Co (Tx)	4	212285556	-21706999	233992555	2	70.50	2	710503616	8	214.08	23
Idaho Pwr Co (Id,Nv,Or)	45	54005151	2292200	51712951	31	67.65	4	181627441	51	237.63	17
Illinois Power Co (Il)	47	86382553	30043621	56338932	29	25.20	59	391530731	20	175.18	44
Indiana & Michigan Elec Co (In,Mi)	26	-7173012	44623079	51796091	30	31.71	42	288896670	30	176.89	42
Indianapolis Pwr and Lt Co (In)	70	38657015	19416000	19241015	69	21.68	71	181783764	50	204.91	30
Interstate Pwr Co (Il,Ia,Mn)	103	17374689	13050055	4324634	109	7.23	113	35487805	117	59.35	116
Iowa Elec Lt & Pwr Co (Ia)	102	15704779	1974929	13729850	81	18.62	79	124454752	71	168.82	50
Iowa Public Service Co (Ia,SD)	113	20099911	5104612	14995299	79	23.91	63	110376335	79	176.01	43
Iowa Pwr & Lt Co (Ia)	100	19777085	3226000	16551085	74	23.32	64	106124840	80	149.53	66
Iowa Southern Utilities Co (Ia)	126	12350675	7772540	4578135	107	16.83	88	42705741	112	157.07	60
Iowa-Illinois Gas & Elec Co (Ia,Il)	105	22491531	8992470	13499061	82	12.33	99	147155601	64	134.46	74
Jersey Central Pwr & Lt Co (NJ)	50	22903445	-23488410	46391855	38	30.39	46	298337557	28	195.44	35
Kansas City Pwr & Lt Co (Ks,Mo)	72	36053999	920578	35133421	50	37.72	21	193020050	47	207.27	27
Kansas Gas & Elec Co (Ks)	77	24426572	1720000	22706572	65	37.31	22	95443244	83	156.84	61
Kansas Pwr & Lt Co (Ks)	84	25912027	2377987	23534040	64	22.22	68	175039628	53	165.32	53
Kentucky Pwr Co (Ky)	90	9778662	138866	9639796	91	22.64	66	70082036	96	164.59	55
Kentucky Utilities Co (Ky,Tn)	65	43187209	22471888	20715321	67	23.17	65	183660797	49	205.49	29
Kingsport Pwr Co (Tn)	132	-1153514	-1181487	27973	139	0.41	138	170807	149	2.55	149
Lake Superior Dist Pwr Co (Mi,Wi)	142	3288214	3192000	96214	137	0.55	137	2701947	147	15.70	146
Long Island Lighting Co (NY)	49	87967702	4477782	83489920	18	35.95	28	120786014	73	52.01	126
Louisiana Pwr & Lt Co (La)	23	60684008	1462985	59221023	26	37.98	19	256010618	39	164.21	56
Louisville Gas & Elec Co (Ky)	75	31183908	-2781342	33965250	53	28.69	50	204429600	44	172.73	48
Madison Gas & Elec Co (Wi)	120	8527497	7742926	784571	128	1.49	133	16689663	127	31.82	142
Maine Public Service Co (Me)	148	-244029	-536099	292069	134	4.12	124	5853335	142	82.72	98
Massachusetts Elec Co (Ma)	60	24712943	18423500	6289443	100	3.46	126	90696844	87	50.03	131
Maui Elec Co (Hi)	150	1527337	479068	1048269	124	13.51	97	15956239	129	205.73	28
Metropolitan Edison Co (Pa)	74	5619830	344081	5275749	103	5.81	116	154289613	60	169.94	49
Michigan Pwr Co (Mi)	144	266442	162424	104018	136	0.28	140	15743728	131	42.93	135
Minnesota Pwr & Lt Co (Mn)	78	30005998	-236618	30242616	58	35.75	30	163777085	57	193.64	36
Mississippi Pwr & Lt Co (Ms)	68	19130465	8429350	10701115	90	13.90	96	113617563	76	147.59	69
Mississippi Pwr Co (Ms)	79	20602655	15438480	5164175	104	9.27	107	116141999	74	208.57	26
Missouri Edison Co (Mo)	137	2589000	2048000	541000	131	6.63	114	4518000	144	55.42	119
Missouri Public Service Co (Mo)	116	8805296	3654812	5150484	105	16.34	90	46883548	108	148.74	67
Missouri Pwr & Lt Co (Mo)	124	4361000	3248000	1113000	123	4.56	121	13206000	133	54.13	123
Missouri Utilities Co (Mo)	130	2843000	1940000	903000	125	5.11	118	12657327	134	71.75	105
Monongahela Pwr Co (Oh,WV)	59	35930245	38324159	-2393914	144	-2.11	143	58104445	101	51.26	129
Montana Pwr Co (Mt,Wy)	73	1177842	54588	1123254	122	0.92	136	81758830	92	67.60	111
Montana-Dakota Util Co (Mt,ND,SD,Wy)	123	16179151	-2108225	18287376	73	25.58	56	92353923	86	129.19	77
Nantahala Pwr & Lt Co (NC)	147	1180631	1062628	118003	135	2.07	130	6026522	141	106.18	87
Narragansett Elec Co (RI)	110	11283272	9517300	1765972	117	3.07	127	24019643	123	41.76	136
Nevada Pwr Co (Nv)	91	21937693	6109875	15827818	76	37.02	25	51463427	102	120.39	81
New Mexico Elec Service Co (NM)	140	1155825	1129137	26688	140	0.31	139	3276968	146	59.28	137
New Orleans Pub Serv Inc (La)	93	4889299	3605000	1284299	121	1.50	132	49464448	104	53.04	118

UTILITY ^a	SIZE OF COMPANY (RANKED BY KWH SALES)	FEDERAL INCOME TAXES CHARGED TO CUSTOMERS ^b	REPORTED FEDERAL INCOME TAX OWED TO GOVERNMENT ^c	1982 PHANTOM TAXES ^d		1982 PHANTOM TAXES PER RESIDENTIAL CUSTOMER ^e		ACCUMULATED DEFERRED TAXES & TAX CREDITS ^f		ACCUMULATED DEFERRED TAXES & TAX CREDITS PER RESIDENTIAL CUSTOMER ^e	
		(\$)	(\$)	(\$)	RANK	(\$)	RANK	(\$)	RANK	(\$)	RANK
New York State Elec & Gas Corp (NY)	63	53606000	3823731	49782269	36	30.14	48	126723045	69	76.72	103
Niagara Mohawk Pwr Corp (NY)	11	100432468	7662853	92769615	13	17.14	87	251973000	40	46.56	134
Northern Indiana Pub Serv Co (In)	56	29586839	31010533	-1423693	143	-46	141	465755207	17	153.40	63
Northern States Pwr Co (Mn,ND,SD)	24	105042552	-22189079	127231631	10	35.08	33	588176047	14	162.19	58
Northwestern Pub Serv Co (SD)	141	5978931	123873	5855058	102	33.52	38	25269831	121	144.70	71
Ohio Edison Co (Oh)	29	74639092	126065	74513027	21	33.96	36	171239086	54	78.04	102
Ohio Power Co (Oh)	14	50172379	28164047	22008332	66	9.49	106	157870226	59	68.08	109
Oklahoma Gas & Elec Co (Ar,Ok)	30	78175292	35891000	42284292	44	27.50	53	266889398	34	173.58	46
Old Dominion Pwr Co (Va)	146	-1015002	-2572654	1557652	118	31.45	44	7304866	139	147.49	70
Orange & Rockland Utilities (NY)	109	20889272	13268458	7620814	97	11.84	100	51299591	103	79.75	100
Otter Tail Pwr Co (Mn,ND,SD)	107	17205915	1076813	16129102	75	60.98	7	70590502	95	266.91	8
Pacific Gas & Elec Co (Ca)	1	695580934	537380712	158200222	6	9.72	105	243502692	42	14.96	147
Pacific Pwr & Lt (Ca,Id,Mt,Or,Wa,Wy)	20	45906774	-24260233	70167007	24	36.51	27	92875896	85	48.32	133
Pennsylvania Elec Co (NY,Pa)	62	31232408	39818177	-8585768	148	-6.16	147	162161602	58	116.36	83
Pennsylvania Pwr & Lt Co (Pa)	25	78316670	-12871755	91188425	14	42.30	13	256617707	38	119.04	82
Pennsylvania Pwr Co (Pa)	112	14030502	1643679	12386823	85	36.81	26	36158840	115	107.48	86
Philadelphia Elec Co (Pa)	15	161771859	7563392	154208467	7	33.63	37	624055199	12	136.12	72
Portland General Elec Co (Or)	43	67422900	-13408994	80831894	19	64.39	6	89869559	89	71.59	106
Potomac Edison Co (Md,Va,WV)	57	32845694	29914612	2931082	113	3.71	125	90112188	88	114.32	84
Potomac Elec Pwr Co (DC,Md,Va)	37	78153723	37254912	40898811	46	21.60	72	302363767	27	159.74	59
Public Serv Co of Colorado (Co)	42	89035847	56089000	32946847	55	8.89	108	202341920	45	54.64	122
Public Serv Co of Indiana (In)	33	98304058	3980850	94323208	12	70.25	3	560076309	15	417.13	1
Public Serv Co of New Hamp (NH,Vt)	88	26343118	102052	26241066	61	37.03	24	48697420	105	68.72	108
Public Serv Co of New Mexico (NM)	85	30538679	3175095	27363584	60	29.60	49	138976367	66	150.37	65
Public Serv Co of Oklahoma (Ok)	46	40078331	21170476	18907855	70	17.57	85	280501578	32	260.70	11
Public Serv Elec & Gas Co (NJ)	16	176639062	38027391	138611671	9	18.99	78	943811005	4	129.31	76
Puget Sound Pwr & Lt Co (Wa)	38	37767000	-1370974	39137974	47	37.11	23	110571006	78	104.86	89
Rochester Gas & Elec Co (NY)	86	25236570	1214817	24021753	62	17.27	86	73820328	94	53.09	125
Rockland Elec Co (NJ)	135	2576952	1746435	830517	126	7.35	111	12548182	135	111.17	85
San Diego Gas & Elec Co (Ca)	64	25637992	-5717620	31355612	57	11.58	103	69903844	98	25.81	144
Savannah Elec & Pwr Co (Ga)	119	6760390	380992	6379398	99	31.63	43	44155134	111	218.95	21
Sierra Pacific Pwr Co (Ca,Nv)	104	21222677	11972862	9249815	92	16.35	89	70040894	97	123.83	80
South Carolina Elec & Gas Co (SC)	58	45403684	2035700	43367984	41	37.97	20	293214896	29	256.78	13
Southern California Edison Co (Ca)	2	101247330	126214000	-24966669	150	-2.47	144	274280268	33	27.24	143
Southern Indiana Gas & Elec Co (In)	108	15779823	7813300	7966523	96	18.02	82	76640426	93	173.38	47
Southwestern Elec Pwr Co (Ar,La,Tx)	41	46696000	4258300	42437700	43	39.21	16	265178475	36	245.05	15
Southwestern Elec Serv Co (Tx)	139	1576900	1014700	562200	130	7.54	110	4493483	145	60.32	115
Southwestern Pub Serv (Ks,NM,Ok,Tx)	52	29543039	10645209	18897830	71	15.16	92	97322132	82	78.08	101
St. Joseph Lt & Pwr Co (Mo)	133	4911320	1363747	3547573	111	26.07	55	22766613	124	167.36	51
Tampa Elec Co (Fl)	67	31022721	10866813	20155908	68	27.95	52	207991921	43	288.50	5
Texas Elec Serv Co (Tx)	28	71853641	29981229	41872412	45	30.44	45	266201338	35	193.54	37
Texas New-Mexico Pwr Co (Tx,NM)	94	7474819	1246695	6228124	101	14.43	93	31214891	119	72.33	104
Texas Pwr & Lt Co (Tx)	19	74878058	36239266	38638792	48	21.73	69	430597851	19	242.24	16
Toledo Edison Co (Oh)	81	45214783	2677190	42537593	42	56.14	8	125966830	70	166.26	52
Tucson Elec Pwr Co (Az)	89	23028490	-35022065	58050555	27	91.54	1	179609265	52	283.23	7

UTILITY ^a	SIZE OF COMPANY (RANKED BY KWH SALES)	FEDERAL INCOME TAXES CHARGED TO CUSTOMERS ^b	REPORTED FEDERAL INCOME TAX OWED TO GOVERNMENT ^c	1982 PHANTOM TAXES ^d		1982 PHANTOM TAXES PER RESIDENTIAL CUSTOMER ^e		ACCUMULATED DEFERRED TAXES & TAX CREDITS ^f		ACCUMULATED DEFERRED TAXES & TAX CREDITS PER RESIDENTIAL CUSTOMER ^e	
		(\$)	(\$)	(\$)	RANK	(\$)	RANK	(\$)	RANK	(\$)	RANK
UGI Corp (Pa)	145	10021979	-5519927	15541906	77	21.73	70	27705302	120	38.73	140
Union Electric Co (Il,Ia,Mo)	22	83130758	-1185000	84315758	17	38.42	17	449012000	18	204.60	31
Union Light Heat & Pwr Co (Ky)	122	4657137	-98737	4755874	106	14.00	95	16578270	128	48.83	132
United Illuminating Co (Ct)	98	25591857	11464712	14127145	80	20.33	76	36061186	116	51.89	128
Upper Peninsula Pwr Co (Mi)	143	3094429	2270618	823811	127	5.44	117	12543156	136	82.84	97
Utah Pwr & Lt Co (Id,Ut,Wy)	36	51291038	20123	51270915	32	34.88	34	257036191	37	174.91	45
Virginia Elec & Pwr Co (NC,Va,WV)	8	152918562	8522261	144396301	8	43.45	11	599992179	13	180.56	40
Washington Water Pwr Co (Id,Mt,Wa)	69	16250844	7138379	9112465	93	10.19	104	46484450	110	51.99	127
West Penn Pwr Co (Pa)	31	56529185	44708543	11820642	88	6.45	115	166511200	56	90.97	96
West Texas Utilities Co (Tx)	97	10899900	2878700	8021200	95	18.35	81	59059915	100	135.12	73
Western Massachusetts Elec Co (Ma)	111	14526487	-830531	15357018	78	40.16	15	88204750	90	230.72	18
Wheeling Elec Co (WV)	125	-325130	52031	-377161	142	-2.65	145	148275	150	1.04	150
Wisconsin Elec Pwr Co (Mi,Wi)	35	68764587	75519509	-6754921	147	-3.25	146	167015357	55	80.52	99
Wisconsin Pub Serv Corp (Wi,Mi)	82	25114000	22334200	2779800	115	2.23	129	48645011	106	39.19	138
Wisconsin Pwr & Lt Co (Wi)	80	38558840	31599905	6958935	98	7.29	112	48109925	107	50.42	130
TOTALS:		7123389872	2035636657	5087753219		AVG: 21.45		29439284020		AVG: 134.67	

Notes for Table

^a150 largest U.S. investor-owned electric utilities, excluding companies with wholesale sales only. Figures include gas operations of combination electric and gas utilities.

^bFederal income tax expenses reported by utility which are chargeable to ratepayers.

^cFederal income taxes reported owed by utility on operating, non-operating, and extraordinary item accounts. Negative amount denotes claim for refund of past taxes or credit against future taxes. Utilities which are subsidiaries of holding companies do not file tax returns with IRS; for such companies, this figure represents a portion of the tax liability of the parent company.

^dTaxes charged to ratepayers minus taxes owed to government.

^eIncludes only amounts charged to residential electric customers. Amounts charged to commercial, industrial, wholesale, and non-electric customers are excluded.

^fAccumulated deferred income taxes and deferred investment tax credits held by utilities as of December 31, 1982.

Source: Form 1 annual reports filed by individual utilities with Federal Energy Regulatory Commission. Calculations by Environmental Action Foundation.

Environmental Action

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Statement of
Richard E. Morgan
Regarding
Phantom Tax Reform and Least-Cost Energy Planning Act of 1984
February 23, 1984

The Phantom Tax Reform and Least-Cost Energy Planning Act would help to solve a serious problem affecting electricity consumers and state utility regulators across the country. Federal tax laws currently require utilities to charge their customers billions of dollars each year for federal income taxes which they are not required to pay. Not only does this law result in massive overcharges of utility consumers, but it also encourages power companies to build costly and unnecessary generating facilities. Rep. Harkin's bill would allow state utility regulators to adopt policies which prevent electric utilities from overcharging for federal income taxes and which encourage improved utility efficiency.

Like other businesses, utilities receive substantial federal tax benefits when they make new investments. Three such benefits, accelerated depreciation, shortened tax lives, and the investment tax credit (ITC), save electric utilities billions of dollars annually on their tax returns, enabling them to pay little or no income tax to the Internal Revenue Service. A unique provision in the tax law, however, states that utilities must charge their customers as if they did not receive these major tax benefits. Thus, in 1981, the power companies billed their customers for \$5 billion in federal income taxes, even though they actually paid only \$1.3 billion to the IRS. The difference--almost \$3.7 billion--is often referred to as "phantom taxes."

Phantom taxes are created by an accounting device known as "normalization." Under this procedure, the tax benefits received when a utility builds a new power plant are passed through to ratepayers gradually as the investment is being depreciated. Consumers and many regulators prefer an alternative known as "flow-through" accounting, whereby a utility passes its tax savings on to consumers immediately. Flow through of major utility tax benefits, however, is not permitted by federal law.

A utility normalizes its ITC benefits from a new power plant by charging its customers as if there were no tax credit. The utility places these unpaid taxes, called "deferred ITCs," in a special account. This money is refunded to ratepayers over the life of the plant, a process which may take 40 years. By the time these refunds take place, however, they are usually more than offset by new ITC charges.

Savings from accelerated depreciation and shortened tax lives are normalized in a different way. The utility charges its customers as if there were no tax breaks. The "taxes" owed to the IRS are placed in a deferred tax account and held there for up to 30 years before they are actually paid. And by the time a utility gets around to paying those taxes, it may have new tax breaks to offset them.

The money in these deferred tax accounts is available for new utility investments such as power plants. These sums grow rapidly from year to year. At the end of 1981, the power companies were holding over \$25 billion in their deferred tax and deferred ITC accounts, according to a U.S. Department of Energy report.

✓ Most utility consumers have been paying phantom taxes since 1969, when Congress first mandated normalization for the majority of utilities benefitting from accelerated depreciation. In 1971, a similar clause was added to the tax code requiring normalization of ITC benefits. Some utilities already using flow-through accounting were exempted from these requirements through a "grandfather" clause. The passage of the Economic Recovery Tax Act of 1981 extended this normalization treatment to all utilities for new investments.

Another feature of the federal tax code allows utilities to collect excess profits through the investment tax credit. The federal law, in effect, requires utility ratepayers to provide capital for ten percent of a new power plant, in the form of deferred ITCs. Many economists and regulators feel that utilities should not earn a return on that portion of the investment. Regulators generally favor a procedure called "economic normalization," whereby the portion of a power plant financed by the ITC is deducted from the rate base upon which utility profits are calculated. Deferred taxes arising from accelerated depreciation and shortened tax lives are generally deducted in this way.

Federal law, however, prohibits economic normalization of ITC benefits. In effect, utilities are able to earn a profit on the entire investment in a new power plant, even though 10 percent of the plant was financed by ratepayers through deferred investment credits. The power companies are thus able to reap a hidden profit from the investment tax credit, and regulators may not consider these added profits when setting a utility's rates. Extra profits from deferred ITCs totaled \$762 million for the power industry in 1981. According to estimates by Illinois regulator Charles Stalon, these hidden profits could reach \$3 billion annually by the 1990s.

✓ When the law requiring utilities to collect phantom taxes was first conceived in the 1960s, it was intended to help growing utilities finance the construction of new facilities. Today this law is encouraging utilities to overbuild and is contributing to the power industry's serious problem of excess generating capacity.

The faster a utility grows, the more phantom taxes it can collect. And as long as a utility keeps growing, it can continue to postpone paying most or all of its federal income taxes. This powerful growth incentive encourages utilities to rely on costly centralized generating technologies and discourages them from pursuing energy conservation and alternative energy strategies.

Because of growth incentives such as phantom taxes, the power companies have pursued a course of expansion which far exceeds the growth in demand for electric power. In the past few years, over \$10 billion in utility construction projects have been abandoned, and the burden of these cancellations will be borne by the nation's ratepayers, taxpayers, and utility shareholders.

In an effort to slow skyrocketing utility bills, state utility regulatory commissions have been seeking ways to encourage more efficient planning and operations by utility companies. At least two states, California and Iowa, have adopted a concept known as "least-cost energy planning," whereby electric utilities must choose from a wide variety of conventional and alternative resources in order to meet their customers' long-term energy needs at the lowest possible cost. By reducing the need for new power plant construction, the least-cost approach can save utilities billions of dollars in financing costs and can result in substantial savings for consumers.

The law requiring phantom taxes does little to engender public confidence in the process of utility regulation. Our state regulators find it difficult to explain why electric bills must include billions of dollars in federal income taxes which the utilities do not really pay.

The law requiring normalized accounting of utility tax benefits poses a serious problem for regulators seeking to promote efficient utility planning. The ability to collect phantom taxes provides utility managers with a strong incentive to continue building centralized power plants, even when their customers' energy needs could be met more cheaply through conservation or other alternatives. Thus, the federal law interferes with the ability of state utility regulators to pursue least-cost energy planning.

The federal government should not dictate to states how they should regulate electric utilities. Each state has its own conditions and problems, and that state's regulators are best equipped to determine the proper expenses to be charged to ratepayers for federal income taxes. State regulators should be free to choose an accounting method for taxes which furthers that state's objectives for planning to meet future electricity needs.

The Harkin bill provides that utility regulators who have adopted a least-cost energy plan for a particular utility would be permitted to choose a tax accounting method which is

consistent with that plan. Thus, if regulators find that normalized accounting is not consistent with efficient utility planning, they would be able to use flow-through accounting instead.

Likewise, state regulators who have approved least-cost plans would be permitted to use economic normalization of ITC benefits in order to prevent utilities from receiving excess profits from deferred ITCs. A further provision of the Harkin bill would require the Federal Energy Regulatory Commission (FERC) to use economic normalization for all deferred taxes and tax credits. (FERC is currently considering allowing electric utilities to keep ITCs permanently, thus providing additional excess profits.)

The Phantom Tax Reform and Least-Cost Energy Planning Act could save consumers billions of dollars annually by eliminating phantom taxes from their electric bills. Additional savings may take place as state utility commissions are freed to pursue efficient energy planning strategies without interference from federal tax laws.

UTILITY TAX DEFINITIONS

Investment tax credit (ITC): A tax credit which is provided for business investments in new machinery, including power plants.

Depreciation: The reduction in value of an asset over time, which results in tax deductions.

Accelerated depreciation: An accounting method whereby depreciation is speeded up for tax purposes, allowing greater tax deductions early in the tax life of an asset.

Tax life: A period of time set by law or regulation over which the value of an asset is depreciated. An asset's tax life can be made shorter than its useful life as a means of accelerating the depreciation.

Flow-through accounting: A method of ratemaking whereby ratepayers are charged for utility income tax expenses only when such taxes are actually due to be paid to the IRS. Thus, tax benefits received by a utility are immediately passed through to its customers in the form of lower rates.

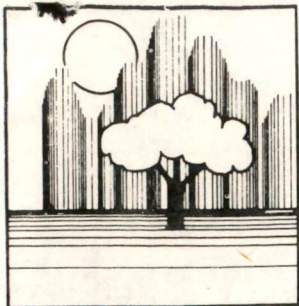
✓ **Normalization:** A method of ratemaking whereby ratepayers are charged for utility taxes as if no tax benefits have been received currently by the utility. Tax expenses collected from ratepayers are retained for a period of time as "deferred taxes" to be eventually paid to the government or as "deferred tax credits" to be gradually rebated to ratepayers.

✓ **Economic normalization:** A form of normalization which prevents a utility from earning a profit on funds in its deferred tax accounts. Economic normalization is widely employed by utility regulators for depreciation benefits, but its use is currently prohibited by federal law for the ITC.

LEGISLATIVE HISTORY OF PHANTOM TAXES

- 1946 Accelerated depreciation first allowed by Treasury Department
- 1954 Internal Revenue Code of 1954
*Accelerated depreciation first allowed by law
- 1955 Pennsylvania utility commission flows through tax benefits from accelerated depreciation to ratepayers
- 1962 Revenue Act of 1962
*Investment tax credit (ITC) first enacted: 3% for public utilities, 7% for other businesses
*Tax lives for depreciation shortened by 1/3 of useful life
- 1960's Trend develops among state utility commissions to flow through tax benefits to ratepayers
- 1969 Tax Reform Act of 1969
*Normalization of accelerated depreciation required by law for all utilities not already using flow-through accounting
- 1971 Revenue Act of 1971
*Faster accelerated depreciation and shorter tax lives adopted causing deferred taxes to skyrocket
*ITC's for utilities increased to 4%; general rate remains 7%
*Normalization of ITC's required for all utilities required to normalize accelerated depreciation under 1969 act
- 1975 Tax Reduction Act of 1975
*ITC increased to 10% for utilities and other businesses
*Utilities allowed ITC for construction work in progress
- 1978 Revenue Act of 1979
*10% ITC made permanent part of federal tax code
- 1981 Economic Recovery Act of 1981
*Tax lives shortened to 10 years (nuclear), 15 years (fossil)
*Accelerated Cost Recovery System (ACRS) adopted allowing very fast depreciation by 1986
*Normalization required for all utility property placed in service after Dec. 31, 1980
- 1982 Tax Equity and Fiscal Responsibility Act of 1982
*Fast depreciation scheduled by ERTA for 1986 is repealed

Prepared by Environmental Action, based on reports by Donald Kiefer of Congressional Research Service.



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April 5, 1984

Dear Folks:

Here is the final version of our new phantom tax report, along with a sample press release, which we promised to send for the April 16th release. We are sending to some of you we haven't heard from yet, because of your interest in the issue.

First, please read the report very carefully. If you are going to be talking with the press and members of Congress, it's important that you have a solid understanding of how phantom taxes work. Moreover, some of our definitions can be a little confusing, so be sure to carefully read the notes at the end of the table which explain what all the figures represent.

The release is set for Monday A.M. April 16, which is Tax Day this year. Please keep everything confidential until then. Naturally, the press should have your release by the previous Friday, but the embargo for Monday should be clearly marked. It's up to you whether you want to provide copies of the report for the press. I'm sure you'll want to make a lot of changes in the press release, but this should help you get started. It needs a lot more juicy quotes.

Besides writing your representatives about the Harkin bill, we suggest you seek endorsements from utility commissioners and other politicians.

If you have any questions, call me at 659-1130.

Good luck and be sure to send us clippings.

Best wishes,

Rick Morgan

P.S. Be sure to point out to the press that the per-customer figures are just part of the total cost to consumers. The full cost is about three times the amount of phantom taxes in residential electric bills. This per-residential-customer figure is useful for comparison purposes, but it doesn't convey the full extent of the cost of phantom taxes.

SAMPLE PRESS RELEASE

HOLD FOR RELEASE UNTIL:
Monday, April 16, 1984

FOR FURTHER INFORMATION CONTACT:

"PHANTOM TAXES" SKYROCKET IN ^(MISSOURI)~~(ILLINOIS)~~

"Although the arrival of April 16 is painful for most Americans, it is a time of celebration for (Missouri') electric companies," charged _____. (Missouri) utilities collected \$\$\$\$ from ratepayers in 1982 for federal tax expenses which they did not pay to the IRS. Over the years the (Missouri) companies have accumulated \$\$\$\$ in ratepayers' money for tax expenses which they have not paid to the IRS.

Across the country, the 150 largest electric utilities overcharged their customers \$5.1 billion for 1982 federal income taxes which they did not pay to the IRS, up from \$3.7 billion in 1981. This represents a cost of \$61 per household. The nation's electric utilities now hold about \$34 billion in unpaid federal income taxes--the equivalent of \$400 per household.

_____ today commended (your representative(s) if they have already cosponsored) for their support of "The Phantom Tax Reform Act" which would revoke the federal law requiring these tax overcharges. They called on the full (Missouri) delegation to join in support of the bill.

In reports filed with the federal government, the (3 Missouri) utilities listed \$\$\$ million as expenses for federal income taxes, but they reported owing only \$\$\$ million to the IRS, _____ said. (Name utility) had the largest tax overcharge in the state, \$\$\$ million, according to the group. The utility charged its customers \$\$\$ million for 1982 federal income taxes,

but owed only \$\$\$ million to the IRS. That represents the _____ largest tax overcharge by a U.S. electric utility, the group said.

Other (Missouri) utilities also charged their customers for phantom taxes in 1982, according to _____. (List your other state utilities.)

Phantom taxes cost the average residential customer of (utility with highest number) \$\$ in higher electric bills. For (your other utilities) the per customer charges were....

The tax overcharge figures have just been released in a research report, Electric Utility Phantom Taxes: 1982 prepared by the Environmental Action Foundation of Washington, D.C. which specializes in the study of the electric utility industry.

The report explains that phantom taxes are created because the current federal tax code requires utilities to charge customers as if they did not receive major tax breaks. In fact, utilities are able to reduce their taxes owed to the IRS by taking a 10% investment tax credit on all new construction and by writing off the value of a new plant in the first few years through accelerated depreciation. The federal tax code prevents state public utility commissions from passing through these tax benefits to ratepayers when they are received.

The tax revenues from ratepayers are recorded in deferred tax and deferred tax credit accounts. Eventually deferred taxes are supposed to be paid to the IRS and deferred tax credits returned to ratepayers; but the utilities are allowed to spend the money as it comes in, rather than saving it for these future payments. Meanwhile, customers must make an involuntary loan to

their utility, the foundation said. As long as a utility continues to grow, it can postpone much of its tax liability indefinitely.

Right now (your utility with highest per customer number for accumulated deferred taxes) has an average of \$\$\$ for each residential customer which they have collected over the years for tax expenses but never paid to the IRS. Other (Missouri) utilities are holding

"The utilities say they will pay this money, but the accounts keep getting bigger every year. How much are they really paying?" asked _____. The Foundation report claims that as long as a utility continues to grow, it can postpone much of its tax liability indefinitely.

"The current phantom tax policy hurts consumers in the long term as well," charged _____. "Utilities use these billions in phantom tax revenues to finance construction of more power plants, instead of pursuing far cheaper conservation measures."

To make matters worse, a utility can charge customers for a profit on the portion of its investments which were financed with investment tax credits. These "hidden profits" totaled \$1.1 billion in 1982, according to the Foundation report. Federal law prevents utility regulators from restricting these added profits.

"Utility rates should be based on actual costs, not on some exercise in accounting legerdemain," _____ concluded.

Ray Czar

1PL

415-839-3346

per Ron Kuchert

on AFDC acctg



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CWIP

Phantom taxes.

1. CWIP enjoys a FDC -- allowance for Funds Amalg. Contra. Interest is capd.

a. Borrowed funds. ~~The~~ Cash outlays are capd. (used to be expensed)

Can't pass them thru to rate payers, now. But are investing them at a guaranteed rate of return.

b. Equity funds. Imputed return is capd. Equity return is typically higher than bond rate.

Corp. often reports this to shareholders as earnings — but not to IRS, which is on cash basis.

2. CWIP does not lead directly to phantom taxes.

3. Deprec. Utility practice allows very slow deprec. to maintain rate base. E.g. 5% deprec. This holds up book inc. — but not IRS inc, which uses fast deprec. & ITC.

PUC lets them put reserves for future taxes into special acct. Future catch-up taxes come when they can't deprec. any more. But they can invest the funds in their own rate base. The return

these funds earn ~~to add to~~ ~~earnings~~ ~~to~~ ~~earnings~~ - probably ¹²
reinvested? Roy said they must reduce rate base by the phantom
tax? - "normalizing"
When they are expanding, deprec. on new stuff
keeps taxes down. For a while they thought they
cd. do this forever.

Now they have large accum. rate bases they
can't deprec. for IRS; & taxes already paid there.
Must draw on reserve accts. to pay taxes. These are
frozen in cap. ~~tax~~ but can be borrowed on. ? presume.

4. ITC.

Here, taxes never catch up. When is benefit flowed
thru to ratepayers?

Roy 5. AFDC is income to utility, never taxed!

PUC recognizes it as inc., flows back.

Roy IRS lets utility deprec. capd. int. - only
taxes ^{P.U.} ~~it~~ on earnings of base, not on buildup of
base!