Edison Electric INSTITUTE

The Financial Statement Income for Capitalized Repair Costs of Regulated Electric Companies Must Be Adjusted in the Implementation of the Corporate Alternative Minimum Tax

The Edison Electric Institute (EEI) is the association that represents all U.S. investor-owned electric companies. EEI's member companies provide electricity to nearly 250 million Americans and operate in all 50 states and the District of Columbia. The electric power industry is one of the most capital-intensive industries in the country, currently investing more than $170 billion each year to make the energy grid stronger, smarter, cleaner, more dynamic, and more secure. Repairing and maintaining transmission and distribution systems is critical to the sector.

EEI's member companies are highly regulated at the state level by state public utility commissions. Under this model, regulators determine or approve the *Revenue Requirement* electric companies are authorized to collect from customers based on (1) the electric company's "cost of service," which is intended to provide the electric company with recovery of its expected costs (including federal income taxes) plus (2) a reasonable return on its invested capital or rate base. Electric companies and regulators must constantly balance reliability and affordability when considering cost impacts to customers.

Today, 20 EEI member companies that provide electricity to nearly 200 million Americans soon expect to be subject to the corporate alternative minimum tax (CAMT), and that number is expected to grow. The CAMT was signed into law as part of the Inflation Reduction Act (IRA). Because of the method used to set regulated electric company rates, the CAMT paid by regulated electric companies will increase the electric bills of the Americans they serve.

Disproportionate Tax Burden: Financial Statement Versus Tax Treatment of Repairs

The financial accounting of a regulated electric company is determined largely by its regulatory accounting, which public utility commissioners use to set rates based on an electric company's cost of service.[1] Under cost-of-service rate regulation, regulators typically require electric companies to capitalize the cost of repairs and to depreciate those costs over the life of the assets, which is typically 35-40 years. This is done to ensure that rates are affordable for current customers and that future customers bear a share of the costs from which they benefit.

[1] The Financial Accounting Standards Board, Accounting Standards Codification 980 (ASC 980) is the codification of rules that apply to the accounting and reporting of regulated operations. Specifically with respect to costs, such as repairs, that otherwise would be charged against current operations under GAAP by non-regulated entities, ASC 980 recognizes a regulator's authority to require capitalization of the costs.

The regulatory practice of capitalizing repair costs and depreciating them over a number of years is a Generally Accepted Accounting Principle (GAAP) for regulated electric companies and is permitted because, unlike other businesses, the costs are probable of collection in future rates.[2]

Unlike GAAP, the federal income tax rules treat the accounting for repair costs of regulated electric companies and non-regulated taxpayers the same. For regular federal income tax purposes, all taxpayers currently are permitted to deduct repair costs as an ordinary and necessary business expense.[3] In other words, regulated electric companies bear an additional CAMT because of their repair expenditures, which non-regulated taxpayers do not, even though they and other taxpayers are making substantially similar repairs and deduct repairs as ordinary and necessary business expenses for tax purposes. Table 1 illustrates this point.

Table 1. Difference in Treatment of Repairs for Regulated Versus Non-Regulated Taxpayers

Repairs Treatment	**Regulated Taxpayer A (EEI members)**	**Non-Regulated Taxpayer B**
Regular Tax	Deduct in the period in which they are incurred	Deduct in the period in which they are incurred
CAMT	Capitalize and depreciate over many years (can be up to about 35 years)	Deduct in the period in which they are incurred

Issues to Consider

The CAMT is a complicated tax system for which Congress provided only a broad statutory framework and delegated substantial authority to the Treasury Department to provide the detailed rules necessary to achieve the intent of the legislation.[4] Due to the process by which the CAMT was enacted, Congress did not provide the legislative history that it typically provides when enacting tax legislation.

The Treasury Department has demonstrated its willingness to exercise that authority in its initial guidance provided in Notice 2023-7, Notice 2023-64, and Notice 2024-10, but so far has not included an adjustment for repairs.[5]

Should Treasury ultimately not provide a repairs adjustment for regulated electric companies through regulations, EEI is seeking a legislative fix.

[2] Wirick, David, and John Gibbons. “Generally Accepted Accounting Principles - TOC - National Association of Regulatory Utility Commissioners (NARUC).” GAAP for Regulated Utilities: Evolution and Impacts, https://pubs.naruc.org/pub/FA85D820-AE63-44EE-A453-F83281D70355.

[3] Treas. Reg. 1.162-4(a).

[4] Section 56A(c)(15) and Section 56A(e).

[5] Examples include application to the depreciation adjustment to cost of goods sold, deductions allowed under section 174, computation of gain or loss on the sale of assets described in section 1221(a)(1) (Notice 2023-7), numerous rules for determining AFSI when foreign members are in the group (Notice 2023-64) and, more recently, in Notice 2024-10 to avoid double counting of CFC income.

Economic Consequences

Imposing an additional tax on items capitalized by regulated electric companies will impact job creation, increase electric bills, and decelerate the progress being made to invest in energy projects. EEI estimates that every $1 million of additional CAMT that a regulated electric company pays and is unavailable to fund its infrastructure needs will cost at least 7 good-paying U.S. jobs.

When proposed by the Administration in May 2021, the CAMT was expected to raise $148 billion in revenue over 10 years and to apply to approximately 120 taxpayers annually.[6] In July 2022, the Joint Committee on Taxation increased the number of taxpayers expected to be subject to the CAMT to 150 and the 10-year revenue estimate to $313 billion, of which fewer than 10 taxpayers were expected to be in the entire utility industry (e.g., electric, gas, water utilities).[7] Yet, even with updated estimates[8] that would provide further CAMT relief for taxpayers, 20 EEI member companies still expect to be subject to the CAMT under the proposed rules, which indicates that the CAMT is having the unintended effect of applying to more electric companies than anticipated.

Examples

Repairs Example: Assume Taxpayer A (regulated electric company) and Taxpayer B (electric company in a competitive market) make $100 worth of repairs. Both taxpayers are subject to CAMT. Assume the repair is expected to last 10 years. Taxpayer A ultimately will have to pay a higher amount under the CAMT compared to Taxpayer B, simply because it is required to do so due to the regulatory accounting rules.

Repairs Example Cost Breakdown

	Regulated Taxpayer A	Non-Regulated Taxpayer B
Financial Statement Income **before** $100 repairs expenditure	$200	$200
Current Year Expense for Repair	$100/10 years = $10	$100
Adjusted FSI, or AFSI (assuming no repairs adjustment can be made)	$200-$10 = $190	$200-$100 = $100
15% on AFSI	0.15 x $190 = $28.5	0.15 x $100 = $15

6 Department of the Treasury, General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals, May 2021. https://home.treasury.gov/policy-issues/tax-policy/revenue-proposals.

7 Joint Committee on Taxation, Proposed Book Minimum Tax Analysis by Industry, Memorandum from Thomas A. Barthold, July 28, 2022. Utilities, NAICs Code 221, is included in "All Other Industries," which includes all industries with fewer than 10 observations. No specific number of electric companies was indicated. The total population of "All Other Industries" was estimated to be about 20 companies.

8 Congressional Budget Office, Estimated Budgetary Effects of Public Law 117-169, Sept. 7, 2022. https://www.cbo.gov/system/files/2022-09/PL117-169_9-7-22.pdf.

Conclusion

Congress should ensure that regulated and non-regulated taxpayers are treated the same under the CAMT, particularly given that regulated electric companies are making critical investments to repair and to maintain our nation’s transmission systems. A legislative fix that adjusts the financial statement income for repair costs that are capitalized and depreciated by regulated electric companies would ensure equitable treatment of regulated electric companies.

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