

Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

Senate Bill 1101

(Senator Green, *et al.*)

Finance

Electric Companies - Taxes Attributed to Regulated Operations

This bill requires the Public Service Commission (PSC) to perform a review of an electric company's collected and paid income taxes and to take specified actions when differences are determined.

The bill takes effect June 1, 2006.

Fiscal Summary

State Effect: The bill's requirements could be handled with existing budgeted resources. The effect on electric company rates, and the impact on State utility costs, depends on an electric company's collected and paid income taxes and cannot be reliably estimated at this time.

Local Effect: The effect on electric company rates, and the impact on local utility costs, cannot be determined without any experience under the bill.

Small Business Effect: The effect on electric company rates cannot be determined without any experience under the bill.

Analysis

Bill Summary: On or before October 15 of each year, an electric company must file a tax report with PSC indicating: (1) the amount of taxes the electric company or "affiliated group" paid in the four preceding years attributed to the regulated operations of the electric company; (2) the amount of taxes authorized to be collected in rates for the

three preceding years; (3) the methodology used to apportion tax expense between regulated and nonregulated entities; and (4) any other information that the PSC considers necessary.

PSC may require an electric company to identify and offer supporting detail for any item of tax expense collected in rates, including any item adding or subtracting an amount from its reserve for tax expense. An “affiliated group” is defined as an affiliated group of corporations of which the electric company is a member and that files a consolidated federal income tax return.

Within 90 days of the report filing, PSC must review the report and determine whether the amount of taxes collected in rates or from ratepayers for any of the four preceding years differed by \$100,000 or more from the amount of taxes paid attributed to the regulated operations of the electric company. Taxes paid that are attributed to the regulated operations of the electric company may not exceed the lesser of: (1) the portion of total taxes paid as a result of income generated by the regulated operations of the electric company; and (2) the total amount of taxes paid by the electric company or the affiliated group.

If the difference is more than \$100,000, within 30 days, PSC must require the electric company to establish an “automatic adjustment clause” which will remain in effect until ordered by PSC. The automatic adjustment clause will account for all taxes paid by the electric company or affiliated group attributed to the regulated operations of the electric company and all taxes that are authorized to be collected through rates so that ratepayers are not charged more than the taxes paid by the company that is attributed to the regulated operations. If PSC determines that the adjustment clause would have a material adverse effect on customers, it can terminate the clause after a specified hearing. An “automatic adjustment clause” is defined as a provision of a rate schedule that provides for rate increases or decreases or both, without prior hearing, reflecting increases or decreases or both in costs incurred, taxes paid to the federal government or the State or a local government, or revenues earned by an electric company that is subject to PSC review.

PSC may authorize an electric company to include in rates: (1) deferred taxes resulting from accelerated depreciation or other tax treatment of utility investment; and (2) tax requirements and benefits that are required to be included in order to ensure compliance with the normalization requirements of federal tax law.

Current Law: An electric company must charge just and reasonable rates as approved by PSC. Just and reasonable rates means a rate that fully considers and is consistent with the public good and will result in an operating income that yields a reasonable return on

the fair value of the company's property used and useful in providing service to the public.

Federal tax laws govern the treatment of regulated income for tax purposes. Below is information on the different tax methods regarding depreciation and normalization requirements.

Depreciation for Public Utilities: Normalization or Flow-through

The flow-through method is the use of the same accelerated depreciation method for figuring the actual income tax liability and for determining the income tax expense for book and ratemaking purposes. The normalization method of accounting contemplates the creation of a reserve for deferred federal income taxes when depreciation for tax purposes is greater than depreciation for book purposes and a reduction in the reserve when depreciation for tax purposes is less than depreciation for book purposes. Generally, the trend is to require public utilities claiming accelerated depreciation to use the normalization method in depreciating public utility property.

A determination of whether the same or a different depreciation method is used for computing tax expense and depreciation expense for tax, rate-making and book purposes must be made in order to find out whether a normalization or flow-through method of accounting is being used.

Background: A recent article in the *New York Times* reported that many electric companies across the nation are collecting billions of dollars from customers for corporate income taxes yet end up paying little or no taxes at all. The practice involves using losses from other subsidiaries to reduce overall taxes owed while still collecting from customers at full rates. A *New York Times* examination of regulatory filings showed that companies with electric utilities in at least 26 states have collected more money for income taxes that were actually paid.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, *New York Times*, Department of Legislative Services

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