Tax Reform and its Implications – Accounting, Reporting, Regulatory & Financial Planning

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Tax Reform “The Beginning”

The House GOP Tax Reform Blueprint
Tax Reform “Inflection Point”
We know that our customers rely on us to provide safe, reliable, affordable, and increasingly clean energy. That is why we believed it was essential that any tax reform legislation supported investments in America’s critical energy infrastructure and kept energy bills as affordable and predictable as possible for all Americans.

Priorities

▪ Reduce the Corporate Tax Rate
▪ Maintain Interest Deductibility for Corporate Debt
▪ Maintain the Deductibility for State & Local Taxes
▪ Maintain Tax Normalization and Address Excess Deferred Taxes (EDT)
▪ Keep Dividend Tax Rates Low and on Par with Capital Gains Tax Rates
Tax Reform “The End”

H.R. 1, The Tax Cuts & Jobs Act gets signed into law on December 20, 2017
The corporate tax rate was reduced from 35% to 21%.

The legislation limits the deductibility of interest and provides full expensing for 5 years, followed by a 20% per year phase-down until 2026; regulated utilities are exempt from both of these provisions (maintain 100% interest deductibility; apply MACRS depreciation).

The deductibility for state & local taxes was maintained, which is a big win for customers.

Normalization provisions similar to the 1986 Act were maintained, and excess deferred taxes will continue to flow back over the life of the asset.

Dividend tax rates were unchanged and remain on par with capital gains tax rates. Similar to the interest deduction, this is a critical component of keeping the cost of capital low.
Tax Reform – Next Steps

- **Implementation – 3 Buckets**
  - Congress
    - Joint Committee on Taxation Blue Book
    - Technical Corrections
    - Tax Bill Part 2
  - Department of Treasury/Internal Revenue Service
    - Rulemakings/Guidance
  - Regulatory Proceedings
    - State Public Utility Commissions
    - Federal Energy Regulatory Commission
Next Steps – Congress

- **Congress**
  - Joint Committee on Taxation (JCT) Bluebook
    • Bluebook’s are typically produced every Congress to provide technical explanations of major tax law changes
    • Expected timeline - ??????????
  - Technical Corrections
    • After Congress passed the ‘86 Tax Reform Act, they passed several technical correction bills
    • Technical Corrections bill this year?
  - Tax Bill Part 2
    • Messaging bill announced by President Trump and Congressional Republicans
    • Make individuals provisions within TCJA permanent
Next Steps – Treasury Guidance

- **Guidance Expectations**
  - Notices
    - Treasury has issued three notices on the toll charge under Section 965 – Notices 2018-07, 2018-13, and 2018-26 – plus Revenue Procedure 2018-17
    - Treasury also has issued Notice 2018-28 on new Section 163(j) interest deduction limitations
  - Regulations
    - Proposed regulations are anticipated to be released beginning summer 2018
    - Treasury’s goal is to complete final regulations by June 2019
Next Steps – Treasury Guidance (cont’d…)

- Treasury has identified the following areas as guidance priorities under tax reform:
  - Carried interest
  - Fringe benefits
  - Section 274 (entertainment expenses)
  - Toll charge under Section 965
  - Interest limitation under Section 163(j)
  - Executive compensation under Section 162(m)
  - Deduction of qualified business income of pass-through entities under Section 199A
  - Bonus depreciation
Treasury Guidance – Interest Deduction Limitation Sec. 163 (j)

- Business Interest 163(j)
  - Regulated Utility Exemption
    - Regulated entities as defined under 163 (j) are exempted from the limitation
    - Biggest question? - Proposed allocation methodology that determines what portion of holding company debt would maintain 100 percent interest deductibility
Treasury Guidance – (Sec. 163 (j) cont’d…)

- Industry Comment Letter
  - Key Principle - Debt is fungible
  - Method of interest allocation based on the relative asset value of each trade or business.
  - Transition Rule for Acquisition Indebtedness
  - New York State Bar Association Letter
  - Partnerships
  - Goodwill should increase the value of assets for purposes of making the interest allocation.
  - Election to allow groups, the assets of which are substantially all (80% or more) used in regulated public utility businesses, to treat the entire group as a regulated public utility
  - Prospective in approach and should allow any reasonable methodology until rules are promulgated
  - 4th Quarter Depreciation
Treasury Guidance – Partnerships – Sec. 163 (j) cont’d…

- **At the Partnership Level:**
  - In the case of a partnership and S corporation, Section 163(j) is applied at the entity level
  - **At the passthrough level:** Any deduction for business interest is taken into account in determining the non-separately stated income or loss of the entity
    - The passthrough determines its ATI
    - The passthrough may deduct business interest in an amount up to 30% of its ATI against non-separately stated income
    - Disallowed interest expense is retained at the S corporation while partnerships allocate disallowed interest expense to its partners
Treasury Guidance – Partnerships – Sec. 163 (j) cont’d…

- **At the Partner Level:**
  - ATI of each partner is determined without regard to the partner’s distributive share of the partnership’s items of income, gain, deduction or loss; and
  - Each partner’s ATI is increased by its distributive share of the partnership’s ‘excess taxable income,’ which is a percentage of partnership ATI equal to unused limitation/total limitation
    - \( \text{ATI} \times \frac{((30\% \times \text{Partnership ATI}) - \text{net business interest expense})}{(30\% \times \text{Partnership ATI})} \)
  - A partner’s distributive share of excess taxable income is equal to its share of non-separately stated income
    - Non-separately stated income is the ‘Ordinary business income or loss’ reflected on Form 1065 (US Return of Partnership Income)
    - The partner’s distributive share is reflected in Box 1 of Schedule K-1 (Form 1065)
  - A partner can use its share of the partnership’s ‘excess taxable income’ to offset the partner’s business interest at the partner level
Basis adjustment and carryforward by partner

- To the extent interest is not deductible at the partnership level, the carryforward (‘excess business interest’) is at the partner level
- The interest expense carryforward may only be offset by the partner’s share of ‘excess taxable income’ of the partnership in the next taxable year (not business income from other sources)
- Each partner’s outside basis is reduced by its share of disallowed interest expense (i.e., basis is not available to support distributions), but basis is restored upon transfer of the interest in a taxable or non-taxable transaction
Treasury Guidance - BEAT

- Base erosion and anti-abuse tax (BEAT)
  - Imposes a new BEAT equal to the excess of (1) 10% of taxable income (5% for years beginning in 2018 and 12.5% for tax years beginning after 2025) generally determined without regard to deductible amounts paid or accrued to a foreign related party (with exceptions including, but not limited to, certain COGS and certain services at cost), including amounts includible in the basis of depreciable or amortizable assets, over (2) regular tax liability, determined after reduction by credits other than R&D credit and capped amounts of other general business credits (regular tax is reduced by all credits for tax years beginning after 2025)
  - BEAT taxable base adds back deductible payments to related parties
Global intangible low-taxed income (GILTI) Guidance

- Subjects US corporate shareholders of CFCs to current US taxation on ‘global intangible low-taxed income’ (GILTI) with a deduction of 50% (reduced to 37.5% for tax years beginning after 2025) of GILTI

- Provides that GILTI is computed annually as the excess of each US corporate shareholder’s ‘net CFC tested income’ over the shareholder’s ‘net deemed tangible income return’
  - Net deemed tangible return is 10% of tax basis in depreciable assets
  - Net deemed tangible return is reduced for interest deducted in the determination of a US shareholder’s net CFC tested income

- Permits a FTC for 80% of foreign taxes deemed paid by the US shareholder with respect to the GILTI inclusion
Treasury Guidance - FDII

Foreign-derived intangible income (FDII)

- Applies to exports of property, licensing and services in which such property/services are used/performed outside the US with a third party
- Allows a 37.5% deduction (reduced to 21.875% for tax years starting after 2025) for FDII produced in the United States
- Provides several requirements that must be satisfied to constitute FDII subject to the preferential rate
Treasury Guidance – Policy Interactions

Diagram elements:
- Toll Charge
- 163(j)
- US Foreign Tax Credit
- GILTI
- General Basket
- OFLs
- Section 862 sales and royalties
- FDII
- BEAT
- Interest expense disallowed
- Taxable income and foreign tax credits
- Deductible interest expense
- GILTI adds to adjusted taxable income
- GILTI inclusion
- GILTI income adds to BEAT
- Expense apportionment
Treasury Guidance – Interagency Interactions

Treasury Secretary Mnuchin

VS

OMB Director Mulvaney
Memorandum of Agreement (MOA) grants Office of Management and Budget (OMB) greater review of tax rules

- Circumstances in which OMB’s Office of Information and Regulatory Affairs (OIRA) will review tax regulations:
  - Could create a serious inconsistency or otherwise interfere with an action planned by another agency
  - Raise novel legal or policy issues
  - Annual non-revenue effect on the economy of $100 million or more
- OIRA generally will have 45 days to review regulations, with an expedited 10- day review period available for rules related to the 2017 tax reform legislation
- Treasury will submit quarterly notice of planned regulations that includes basis for determining whether each rule is subject to OIRA review
- April 11, 2018 MOA replaces a 1983 agreement
<table>
<thead>
<tr>
<th>Key provision</th>
<th>Anticipated release date</th>
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<tbody>
<tr>
<td>Rules relating to Section 965 transition tax</td>
<td>August 2018</td>
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<td>Foreign tax credit guidance under new tax law</td>
<td>August 2018</td>
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<tr>
<td>Global intangible low-taxed income (GILTI)</td>
<td>September 2018</td>
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<td>Section 250 regulations on deductions for foreign derived intangible income (FDII) and GILTI</td>
<td>November 2018</td>
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<td>Regulations related to recent modifications of Sections 951(b) and 958(b)</td>
<td>December 2018</td>
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<td>Guidance under Section 199A (anti-abuse)</td>
<td>December 2018</td>
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<td>Guidance under Section 199A (definitions)</td>
<td>December 2018</td>
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<tr>
<td>Guidance under Section 199A (computational)</td>
<td>December 2018</td>
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<tr>
<td>Rules regarding business interest limitation under Section 163(j)</td>
<td>December 2018</td>
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<td>Guidance under Section 163(j) applicable to pass-through entities</td>
<td>December 2018</td>
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Source: OMB Office of Information and Regulatory Affairs
Next Steps – State Regulatory Proceedings

- TCJA Proceedings
  - Companies have announced approximately $5 billion in tax reform benefits heading back to customers
  - Customers may see a reduction in their bills or bill credits; potential rate increases may be avoided; or the benefit may be applied toward needed energy infrastructure improvements
  - Proceedings moving forward in almost every state
  - Main focus of the proceedings is the drop in the corporate rate
## EEI Tax Reform Tracker

<table>
<thead>
<tr>
<th>State</th>
<th>Action</th>
<th>Description</th>
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<tbody>
<tr>
<td>Arizona</td>
<td></td>
<td>The Arizona Corporation Commission opened a docket in late December 2017, ordering all regulated entities to: 1) file an application for a tax expense adjustor mechanism, 2) File their intent to file a rate case within 90 days, or 3) if a rate case filing is not expected, file an intent to file any such other application to address rate making implications of the Tax Cuts and Jobs Act. On February 26, 2018, the ACC issued an order in this docket directing electric companies to use regulatory accounting treatment to track the impact of the lower federal tax rate.</td>
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<td>APS: Part of the company’s settled rate case in 2017 addressed how it would handle tax reform, if enacted: “In the event that significant Federal income tax reform legislation is enacted and becomes effective prior to the conclusion of APS’s next general rate case, and such legislation materially impacts the Company’s annual revenue requirements, APS will create a rate adjustment mechanism to enable the pass-through of income tax effects to customer.” In March 2018, APS announced that customers would see an average reduction of $5.40 on their monthly bill as a result of $119 million in federal corporate tax cuts.</td>
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<tr>
<td>Arkansas</td>
<td></td>
<td>On January 12, 2018, the Arkansas Public Service Commission initiated a proceeding to review implications of tax reform on rates. By mid-February, each electric company had submitted an analysis of the effects of the tax act on ratemaking and revenue requirements. Additionally, each IOU began to book regulatory liabilities to record the current and deferred impacts by using best estimates. The Commission issued a procedural schedule for this docket at the end of February. The investigation will run through the end of May.</td>
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<td>Black Hills Rate Case: 17-071-U As part of the general docket noted above, the Arkansas PSC ordered Black Hills Energy Arkansas to adjust their pending rate case to reflect necessary adjustments related to the TCJA.</td>
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<tr>
<td></td>
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<td>Energy Arkansas Rider Request: 18-014-TF In a filing separate from the general proceeding on tax reform, Entergy Arkansas filed a request with the PSC to establish a tax adjustment rider to provide retail customers with tax benefits.</td>
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FERC Notice of Inquiry (NOI)

- Background
  - On March 15, 2018, FERC issued several and a NOI regarding the effect of the TCJA on Commission-Jurisdictional Rates.
  - In the NOI, FERC specifically solicited comments on how to address the impacts of tax reform on accumulated deferred income taxes (ADIT) and bonus depreciation.
Next Steps – Federal Regulatory Proceedings (cont’d)

- FERC Notice of Inquiry (cont’d)
  - EEI Comment Letter
    - Filed Comments on May 21st
    - Focused largely on 3 key areas:
      - Just and Reasonable Rates – Just because the tax bill passed does not make rates unjust and unreasonable
      - Guidance is Needed, But Implementation Will Be Company Specific – There is no one size fits all answer to ADIT
      - Financial Health of Public Utilities/Impacts on Rates - Commission action on excess ADIT balances could have an impact on public utilities’ credit worthiness
Tax Reform – What Does the Future Hold?

- Additional Treasury Guidance
  - Normalization
- Technical Corrections
  - Potentially in the Fall/Winter
- Future Regulatory Proceedings
  - Questions surrounding ADIT
- Political
  - Election
  - Could all of this go away?