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November 7, 2014

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PUBLIC SERVICE
COMMISSION

Mr. Jeff Derouen
Executive Director
Public Service Commission
211 Sower Blvd.
Frankfort, KY 40601

Re: Atmos Energy Corporation

Dear Mr. Derouen:

In its Order dated April 22, 2014 in Case No. 2013-00148, the Commission directed Atmos Energy Corporation (Atmos Energy) to submit a request to the Internal Revenue Service (IRS) for a Private Letter Ruling (PLR) on the issue of Net Operating Loss Carry-forward (NOLC). Specifically, the Commission stated:

> Although we are rejecting the AG's proposal, the aforementioned ambiguity in the regulations and the significantly different interpretations of those regulations by the AG and Atmos-Ky. cause the Commission to conclude that it would be beneficial to have a more definitive assessment of this issue. Therefore, we find that Atmos-Ky. should seek a private-letter ruling from the IRS with the intent that such ruling be filed with the application in Atmos-Ky.'s next general rate case. (Order of April 22, 2014, Case No. 2013-00148, p. 7)

To comply with that directive, Atmos Energy has in consultation with its outside tax attorneys prepared a draft letter seeking a ruling on the regulatory implications of including NOLC in rate base. The letter sets forth the factual and legal issues to be resolved and requests a ruling on the specific issues raised. A copy of the letter is attached.

The IRS regulation for submitting a request for a PLR of this nature requires the Commission to review the letter and to acknowledge that the request is adequate and complete:

Excerpt from Rev. Proc. 2014-1, Appendix E, Section .01:

Rate orders; regulatory agency; normalization A letter ruling request that involves a question of whether a rate order that is proposed or issued by a regulatory agency will meet the normalization requirements of § 168(f)(2) (pre-Tax Reform Act of 1986, § 168(e)(3)) and former §§ 46(f) and 167(l) ordinarily **will not be considered unless the taxpayer states in the letter ruling request whether—**

(1) **the regulatory authority responsible for establishing or approving the taxpayer's rates has reviewed the request and believes that the request is adequate and complete; and**

(2) the taxpayer will permit the regulatory authority to participate in any Associate office conference concerning the request.

If the taxpayer or the regulatory authority informs a consumer advocate of the request for a letter ruling and the advocate wishes to communicate with the Service regarding the request, any such communication should be sent to: Internal Revenue Service, Associate Chief Counsel (Procedure and Administration), Attn: CC:PA:LPD:DRU, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044 (or, if a private delivery service is used: Internal Revenue Service, Associate Chief Counsel (Procedure and Administration), Attn: CC:PA:LPD:DRU, Room 5336, 1111 Constitution Ave., NW, Washington, DC 20224). These communications will be treated as third party contacts for purposes of § 6110.

Atmos Energy's submission of the proposed PLR to the Commission is for the purpose of complying with the regulation. After the Commission has reviewed the letter, representatives of Atmos Energy will be available to meet with the Commissioners and staff to respond to any questions about the substance of the letter or the filing procedures.

Once there is an agreement among Atmos Energy and the Commission regarding the adequateness and completeness of the PLR request, the Commission must acknowledge its review of and concurrence with the letter. To assist the Commission with the preparation of that acknowledgement, a draft letter is attached. The content of the letter conforms to the typical form and substance of similar letters from regulatory agencies. A copy of that letter will be submitted to the IRS with the PLR request.

As the regulation cited above states, if a consumer advocate - in this case the Attorney General's Office of Rate Intervention - is notified of the PLR request, it may submit comments directly to the IRS after the PLR request has been submitted to the IRS. Atmos Energy intends to provide a copy of the PLR request to the Attorney General after it is filed with the IRS as the regulation provides.

Atmos Energy anticipates that the IRS will take between four and six months to issue a ruling. It would like to submit the PLR request no later than December 15, 2014. To meet that objective, Atmos Energy would like to conclude its discussions with the Commission prior to that date.

Should you have any questions or if you would like to schedule a conference with Atmos Energy representatives to discuss these issues, please contact me.

Submitted By:

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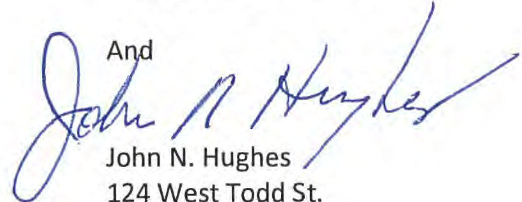

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{DATE}

VIA HAND DELIVERY

Associate Chief Counsel
Passthroughs & Special Industries
Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:DRU, Room 5336
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Ruling Request for Atmos Energy Corporation (EIN#

Dear Sir or Madam:

A ruling is respectfully requested on behalf of Atmos Energy Corporation ("Atmos Energy" or "Taxpayer") regarding the application of the depreciation normalization rules of §168(i)(9) of the Internal Revenue Code of 1986, as amended ("Code"), and Treas. Reg. §1.167(l)-1 (together, "Normalization Rules") to certain accounting and regulatory procedures which are described in detail hereafter.

STATEMENT OF FACTS

Taxpayer

Atmos Energy is incorporated under the laws of Texas and Virginia. Its principal place of business is located at Three Lincoln Center, Suite 1800, 5430 LBJ Freeway, Dallas, Texas 75240, its telephone number is (972) 934-9227 and its taxpayer identification number is . Taxpayer employs the accrual method of accounting and reports on the basis of a fiscal year ending September 30.

Atmos Energy is the common parent of an affiliated group of corporations that join in the filing of a consolidated federal income tax return. This return is filed with the Internal Revenue Service Center in Ogden, Utah and Taxpayer is under the audit jurisdiction of the Large Business and International Division of the Internal Revenue Service ("IRS" or "Service").

Taxpayer's Business

Atmos Energy is engaged primarily in the regulated natural gas distribution business, the regulated transmission and storage businesses and, through affiliates, in other non-regulated natural gas businesses. Its regulated natural gas distribution business delivers natural gas to approximately 3.1 million customers in Colorado, Kansas, Texas, Louisiana, Mississippi, Tennessee, Kentucky, and Virginia.

This ruling request stems from a recent rate case proceeding involving Atmos Energy's gas distribution business in Kentucky ("Atmos KY"). Taxpayer serves approximately 173,000 residential, commercial, and industrial customers in central and western Kentucky. Atmos KY is subject to regulation by the Kentucky Public Service Commission ("KPSC") with respect to the terms and conditions of service and particularly as to the rates it can charge for the provision of service. Its rates are established by the KPSC on a "rate of return" (*i.e.*, cost) basis.

Taxpayer's Accounting for Its Projected Net Operating Loss Carryforward

Taxpayer incurred net operating loss carryforwards ("NOLCs") during its tax years 2009, 2010, 2011 and 2012. In each of those years, Taxpayer claimed accelerated (including bonus)

depreciation to the extent it was available. As of September 30, 2012, Taxpayer' regulated utility operations had produced a federal NOLC of approximately $960 million.

Where an excess of tax deductions over book expenses reduces Taxpayer's positive taxable income, such deductions reduce (*i.e.*, defer) the tax liability it would otherwise pay and, thereby, produce incremental cash flow for use by Taxpayer. For financial reporting purposes, the existence of this incremental cash is recorded in a set of entries which results in crediting (increasing) a reserve for deferred taxes. The following example illustrates the federal income tax-related accounting entries, given the following assumptions: [1]

ASSUMPTIONS	
Pre-tax book income	$1,000
Tax deductions in excess of book expenses	$1,000
Taxable income	$0
Tax rate	35%

ACCOUNTING ENTRIES		
	DR.	CR.
Current tax expense (a/c 409 – income)	$0	
Taxes payable (a/c 236 – balance sheet)		$0
Deferred tax expense (a/c 410 – income)	$350	
Accumulated deferred taxes (a/c 282 and 283 – balance sheet)		$350

[1] The designation "a/c" refers to the account number used by Taxpayer in its accounting records, including its regulated books of account. These account numbers are prescribed by the Federal Energy Regulatory Commission.

In the example, total tax expense is $350, all of which is deferred tax expense. The accumulated deferred income tax ("ADIT") accounts reflect a $350 balance.

However, when Taxpayer incurs a tax net operating loss that results in an NOLC, some portion of the deductions claimed in that period does not, in fact, defer tax. That portion merely creates or increases the NOLC. Thus, while this portion has the capacity to reduce Taxpayer's tax payments in the future, it has not yet done so. When an NOLC occurs, Taxpayer makes a set of accounting entries that reflect these economics. An example follows which illustrates the federal income tax-related accounting entries when an NOLC occurs, given the following assumptions:

ASSUMPTIONS	
Pre-tax book income	$1,000
Tax deductions in excess of book expenses	$2,500
Taxable loss/NOLC	($1,500)
Tax rate	35%

ACCOUNTING ENTRIES		
Basic entries before NOLC impact:	DR.	CR.
Current tax expense (a/c 409 – income)	$0	
Taxes payable (a/c 236 – balance sheet)		$0
Deferred tax expense (a/c 410 – income)	$875	
Accumulated deferred taxes (a/c 282 and 283 – balance sheet)		$875
Entries to reflect the impact of the NOLC:		
Deferred tax assets (a/c 190 – balance sheet)	$525	
Deferred tax expense (a/c 410 – income)		$525

When the two sets of entries described above are combined, the net entries are as follows:

COMBINED ACCOUNTING ENTRIES		
	DR.	CR.
Current tax expense (a/c 409 – income)	$0	
Taxes payable (a/c 236 – balance sheet)		$0
Deferred tax expense (a/c 410 – income)	$350	
Deferred tax assets (a/c 190 – balance sheet)	$525	
Accumulated deferred taxes (a/c 282 and 283 – balance sheet)		$875

In the example, total tax expense is again $350, all of which is deferred tax expense. The deferred income tax expense attributable to the tax deductions in excess of book expenses ($2,500 X 35% or $875) is reduced by the negative deferred income tax expense related to the NOLC ($1,500 X 35% or $525). The combined ADIT accounts reflect a net $350 balance which

consists of two components - $875 in a/c 282 and 283 (deferred tax liability or "DTL") and an offsetting $525 in a/c 190 (deferred tax asset or "DTA").

Taxpayer's Recent Kentucky Rate Case

On May 13, 2013, Taxpayer filed an application with the KPSC to change its rates (Case No. 2013-00148).[2] Its proposed increase was based on a fully forecasted test period consisting of the twelve months ending on November 30, 2014. Taxpayer derived its rate base by applying a 13-month average to its forecasted test period data. Taxpayer updated, amended and supplemented its data several times during the course of the proceedings. In computing its income tax expense element of cost of service, Taxpayer normalized the tax benefits attributable to accelerated depreciation. In the setting of utility rates in Kentucky, a utility's rate base is offset by its ADIT balance. In a Final Order dated April 22, 2014 ("Final Order"), the KPSC approved a rate adjustment for service rendered on or after January 24, 2014. A copy of the Final Order is appended as Attachment 1.

Ratemaking for Taxpayer's NOLCs

In its computation of jurisdictional rate base in the above-referenced rate filing, Taxpayer reflected a reduction of approximately $46 million on account of its projected ADIT balance. This balance included both federal and state ADIT. The amount reflected (1) an allocation of Taxpayer's total utility operation ADIT balance to its Kentucky gas distribution operations and

[2] This filing was accepted as a complete filing on June 24, 2013.

(2) the application of the 13-month average convention used for all elements of rate base. The $46 million amount was comprised of two components: a DTL of approximately $66 million derived from Taxpayer's non-NOLC-related deferred tax items (primarily, its a/c 282 and 283 balances) and a DTA of approximately $20 million attributable to Taxpayer's federal and state NOLCs (reflected in its a/c 190).

In its rate case filing and throughout the proceeding, Taxpayer maintained that the proper amount of ADIT by which its test year rate base should be reduced was the net of its approximately $66 million DTL and its approximately $20 million NOLC-related DTA. It based this position on the fundamental economic fact that this net amount represented the true measure of income taxes actually deferred in connection with the Kentucky gas distribution operation and, hence, it represented the quantity of "cost-free" capital available to that business. Taxpayer further asserted that a failure to incorporate into its ADIT balance calculation the NOLC-related balance in a/c 190 would be inconsistent with the Normalization Rules (discussed in detail hereafter).

During the proceeding, the Kentucky Office of the Attorney General ("AG") argued that Taxpayer should not be permitted to incorporate the tax effect of its NOLC into its ADIT calculation and proposed to reduce rate base by approximately $66 million on account of ADIT instead of the $46 million proposed by Taxpayer. The AG supported its proposal by asserting:

1. The portion of Taxpayer's NOLC-related DTA are increasing over time;

2. If Taxpayer's NOLC expires unused then customers would be paying a return on a benefit that will never exist;
3. The Normalization Rules do not require the recognition of the NOLC-related DTA; and
4. One other regulatory jurisdiction (West Virginia) has ignored a utility's NOLC-related DTA in computing its ADIT balance.

In its Final Order, the KPSC described the disagreement between Taxpayer and the AG regarding the recognition of the NOLC-related DTA in the computation of rate base and concluded:

> The Commission is not persuaded by the AG's argument. While there is some ambiguity in the Treasury regulations cited by the AG and Atmos-Ky. on the subject of NOLCs, we are unable to agree with the AG that a tax normalization violation would not result from a decision to remove NOLCs from Atmos-Ky.'s rate base. The AG has not made a compelling argument for why, from a ratemaking perspective, it would be reasonable to adopt his recommendation.[3]

The KPSC further stated:

> Although we are rejecting the AG's proposal, the aforementioned ambiguity in the governing regulations and the significantly different interpretations of those regulations by the AG and Atmos-KY. cause the Commission to conclude that it would be beneficial to have a more definitive assessment of this issue. Therefore, we find that Atmos-KY. should seek a private-letter ruling from the IRS with the intent that such ruling be filed with the application in Atmos-KY.'s next general rate case.[4]

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[3] Final Order at pages 6-7.
[4] Final Order at page 7.

This request for a private letter ruling ("PLR") is being submitted pursuant to the Final Order.

RULINGS REQUESTED[5]

Taxpayer respectfully requests the following rulings:

> *1. Under the circumstances described above, the reduction of Taxpayer's rate base by the balance of its ADIT accounts 282 and 283 unreduced by its NOLC-related deferred tax account (a/c 190) balance would be inconsistent with (and, hence, violative of) the requirements of Code §168(i)(9) and Treasury Regulations §1.167(l)-1.*
>
> *2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related deferred tax account (a/c 190) that is less than the amount attributable to accelerated depreciation computed on a "last dollars deducted" basis would be inconsistent with (and, hence, violative of) the requirements of Code §168(i)(9) and Treasury Regulations §1.167(l)-1.*

[5] Taxpayer recognizes that the Normalization Rules apply only to the benefits of accelerated depreciation. With regard to a/c 283, none of the balance relates to accelerated depreciation and, hence, this portion of Taxpayer's ADIT balance is not subject to the normalization rules. With regard to a/c 282, some of the account balance relates to accelerated depreciation. Some relates to other items such as state taxes and repairs. Thus, some, but not all, of this balance will be subject to the Normalization Rules. With regard to a/c 190, only the portion of the account balance that is attributable to the federal NOLC produced by claiming accelerated depreciation is subject to the Normalization Rules. Henceforth in this ruling request, references to balances in a/c 282 and a/c 190 will denote the portion of those account balances that are subject to the Normalization Rules.

STATEMENT OF LAW

Former Code §38(c)(1) provided that an investment tax credit ("ITC") is allowed only to the extent its use is not limited by the taxpayer's tax liability.

Code §168(f)(2) provides that MACRS depreciation does not apply to any public utility property if the taxpayer does not use a normalization method of accounting.

Code §168(i)(9) provides that, in order to use a normalization method of accounting, if a taxpayer claims a depreciation deduction that differs from its regulatory depreciation, the taxpayer must make an adjustment to a reserve to reflect the deferral of taxes resulting from such difference. It further provides that any procedure or adjustment that is used for tax expense, depreciation expense or the reserve for deferred taxes must be used with respect to the other two and with respect to rate base.

Treas. Reg. §1.46-6(g)(2) provides that the ITC normalization rules permit the ratable amortization only of ITC "allowed."

Treas. Reg. §1.167(l)-1(h)(1)(iii) provides that, if, in respect of any year, the use of other than regulatory depreciation for tax purposes results in an NOLC carryover (or an increase in an NOLC which would not have arisen had the taxpayer claimed only regulatory depreciation for tax purposes), then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

Treas. Reg. §1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of accounting if the reserve by which rate base is reduced exceeds the amount of such

reserve used in determining the taxpayer's expense in computing cost of service in such ratemaking.

PLRs 7836038 (June 8, 1978) and 7836048 (June 9, 1978) both addressed the use by California regulators of the "average annual adjustment method" ("AAAM") for setting rates. In each of the rulings, the Service held that the AAAM violated the Normalization Rules because it flowed through a portion of the reserve for deferred taxes to customers.

PLR 8818040 (February 9, 1988) involved a taxpayer who generated NOLCs in 1985 and 1986 which it carried forward and used to offset taxable income in 1987. Accelerated depreciation claimed with respect to public utility property contributed to the NOLCs. The tax rate was 46% in both 1985 and 1986 and was 39.95% in 1987. The taxpayer recorded no deferred taxes applicable to the depreciation that produced the NOLCs in the years in which the deductions were claimed (1985 and 1986) but, instead, recorded the applicable deferred taxes in 1987 when the NOLCs were absorbed at the lower 39.95% tax rate in effect in that year. The Service held that this procedure complied with the Normalization Rules.

PLR 8903080 (October 26, 1988) addressed, *inter alia*, a situation in which the taxpayer generated an NOL which could be carried back to a year in which the tax rate was higher than the tax rate applicable to the year in which the NOL was generated. The Service ruled that the allocation of the benefit of the higher tax rate ratably to all book-tax timing differences, including accelerated depreciation, incurred in the NOL year complied with the Normalization Rules.

PLR 9309013 (December 1, 1992) involved a utility taxpayer who had made an election to treat its ITC pursuant to the requirements of former Code §46(f)(2). The taxpayer claimed ITC with respect to certain public utility property but was unable to use credit due to the limitation based on its tax liability of Code §38(c)(1). The unused ITC was carried forward. The Service ruled that the ITC normalization rules (of former Code §46(f)) would be violated if the ITC was used to reduce cost of service in a period before it was used as an offset against Federal income tax.

In PLR 9336010 (June 7, 1993) the Service again addressed a situation in which the taxpayer generated an NOL which could be carried back to a year in which the tax rate was higher than the tax rate applicable to the year in which the NOL was generated. The question raised was the extent to which the NOL carryback was attributable to accelerated depreciation and, hence, gave rise to excess deferred taxes. The Service held that, if no particular items caused the NOL, then an appropriate methodology would be the pro rata allocation of the excess deferred taxes to all timing differences for the year of the NOL.

In PLR 201418024 (May 2, 2014), the Service addressed the implications under the Normalization Rules of the treatment of a utility taxpayer's NOLC. In setting rates, the utility's regulators reduced the utility's rate base by its ADIT balance. The utility had an NOLC-related DTA that was attributable to accelerated depreciation deductions. The utility argued that the Normalization Rules required that its DTA be factored into the ADIT computation for this purpose. The regulators asserted that their process for setting rates already recognized the effects

of the utility's NOLCs insofar as it included "a provision for deferred taxes based on the entire difference between accelerated tax and regulatory depreciation, including situations in which a utility has an NOLC. . . ." The Service concluded that, if the regulators took the effect of the NOLC into account when establishing the tax expense element of cost of service, as they asserted they did, then the Normalization Rules did not require that the DTA to also be considered in the determination of rate base.

In PLRs 201436037, 201436038 (both September 5, 2014) and 201438003 (September 19, 2014) the Service addressed the treatment of NOLCs in ratemaking. In each of those rulings the Service concluded that (1) to the extent that the taxpayer's NOLC-related DTA is attributable to accelerated depreciation, it must reduce the ADIT balance by which rate base is reduced and (2) the NOLC is attributable to accelerated depreciation to the extent that the claiming of accelerated depreciation created or increased the NOLC in the taxable year (*i.e.*, a "last dollars deducted" computation).

DISCUSSION AND ANALYSIS

Requested Ruling #1.

As a result of Taxpayer's accumulated NOLCs, its ability to benefit from some of its accelerated depreciation tax deductions has been delayed until such time as the NOLCs can be used to offset future taxable income and thereby reduce a future tax liability. Treas. Reg. §1.167(l)-1(h)(1)(iii) is the only place in the normalization regulations in which an NOLC is

mentioned. That subparagraph applies when a taxpayer produces an NOLC and claims depreciation deductions that exceed regulatory (*i.e.*, book) depreciation for the year. In such a situation, the section provides that the tax deferral shall be taken into account for regulatory purposes in such time and manner as is satisfactory to the district director.[6]

This provision indicates, at the very least, that the Normalization Rules factor into the timing of tax benefit recognition where there is an NOLC. In other words, it identifies an NOLC situation as one that is distinctive under the Normalization Rules. The very existence of this language indicates that the regulatory treatment of an NOLC has normalization implications. The involvement of the district director would, of course, be unnecessary unless the timing and manner of benefit recognition was important to compliance with the Normalization Rules. So, while this provision may not prescribe a definitive answer regarding what the Normalization Rules actually require, it indicates that they are implicated when a utility has both an NOLC and accelerated depreciation in the same year.

PLR 8818040 specifically addressed the application of the Normalization Rules in the context of an NOLC. In that ruling, the Service described the circumstances of a utility taxpayer with an NOLC as follows:

> However, the taxpayer did not realize the entire tax benefit from the ACRS depreciation claimed in 1985 and 1986 because the depreciation resulted in a

[6] This regulation section employs a "last dollars deducted" measurement in order to determine whether the district director's discretion comes into play. That is, accelerated depreciation is deemed to be the last deduction claimed.

> NOL carryover to 1987. Therefore, in order to reflect the tax benefit of the NOL carryover to 1987, the taxpayer reduced its deferred Federal income tax expense and liability for 1985 and 1986 for financial reporting purposes. The net effect of this accounting in 1985 and 1986 was to record no deferred taxes applicable to the amount of ACRS depreciation that produced no current tax savings but rather caused or increased taxpayer's NOL carryover to 1987. The taxpayer only recorded deferred taxes applicable to ACRS when and to the extent that the use of ACRS produced an actual tax deferral.

The Service concluded that, where the utility produced NOLCs in years in which it claimed accelerated depreciation, its decision not to "book" deferred taxes in the years in which the deductions were claimed and its "booking" of deferred taxes in the year in which the NOLCs were eventually used was consistent with the Normalization Rules.[7] This PLR confirms that NOLCs must pass muster under the Normalization Rules.

Treas. Reg. §1.167(l)-1(h)(6)(i) is potentially much more directly relevant to Taxpayer's situation. This provision imposes a limitation on the extent to which a taxpayer can reduce its rate base by its ADIT reserve. The provision requires that any ADIT balance used to reduce rate base must have been reflected as deferred tax expense in computing cost of service. In other words, there is a necessary connection between deferred taxes in cost of service and the

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[7] Note, however, that the issue in PLR 8818040 was not the limitation on the amount by which rate base can be reduced. It was the computation of the tax expense element of cost of service. Therefore, though the situation was similar to Taxpayer's, the Service's holding is not directly relevant to this ruling request. Moreover, in that ruling the Service held that the taxpayer's delay in the booking of its deferred taxes was consistent with the Normalization Rules - not that to do otherwise would not be.

permissible ADIT balance by which rate base can be reduced. From an accounting as well as an economic perspective, such a connection clearly does exist. This provision of the regulations suggests that, as a condition of complying with the Normalization Rules, this connection must also exist in establishing rates.

The regulation itself offers no rationale for this rule. One can, however, surmise that it was intended to preclude the extraction of the benefits of accelerated depreciation by inflating an ADIT balance beyond the amount that is economically justified. In fact, this was the basis upon which the Service found the AAAM used by the regulators in California inconsistent with the Normalization Rules in PLRs 7836038 and 7836048. The "consistency rules" of Code §168(i)(9)(B) make (and were enacted to make) absolutely clear that identical ratemaking conventions must be applied to the computation of depreciation expense, tax expense, the ADIT reserve and rate base. In recognizing ADIT for purposes of computing rate base that has not been reflected in tax expense, two differing conventions are being applied and that contravenes the consistency rules.

The ITC normalization rules of former Code §46(f) address a situation possibly analogous to Taxpayer's. Under those rules, a taxpayer is not permitted to commence the amortization of its ITC until the credit is used to reduce its Federal income tax liability. See PLR 9309013. Thus, under this "other" branch of the normalization rules, utility taxpayers are prohibited from providing the benefit of a protected tax attribute (ITC) to ratepayers before they themselves receive the benefit. To do otherwise would violate the ITC normalization rules.

Because the "fronting" of a tax benefit in such a way diminishes the value of the benefit to the utility, the protection of the value of ITC to a utility taxpayer described above suggests a counterpart requirement in the case of accelerated depreciation. Providing ratepayers a benefit produced by accelerated depreciation before that deduction reduces a tax liability economically diminishes the value of accelerated depreciation. That is what occurs where the effect of an NOLC is not considered in ratemaking. In fact, and counterintuitively, a utility subject to such ratemaking (that is, ratemaking that ignores the ADIT impact of the NOLC) would be better off not claiming accelerated depreciation to the extent it creates or increases an NOLC. If the utility did not claim these additional depreciation deductions, the tax it paid would not be impacted – it would still be zero. However, absent the NOLC, the utility would not reflect additional and offsetting amounts in a/c 282 and a/c 190. As a result, its rate base would not be reduced by the incremental balance in a/c 282. In short, its rate base would not be reduced by the tax benefit of tax deferrals that have not yet occurred.

A review of the accounting entries on page 5 of this request demonstrates the Normalization Rule problem with the failure to recognize an NOLC-related DTA in the computation of rate base. Where there is an NOLC, the combined accounting entries are as follows:

	DR.	CR.
Current tax expense (a/c 409 – income)	$0	
Taxes payable (a/c 236 – balance sheet)		$0

Deferred tax expense (a/c 410 – income)	$350	
Deferred tax assets (a/c 190 – balance sheet)	$525	
Accumulated deferred taxes (a/c 282 – balance sheet)		$875

The table indicates that, in the example, the deferred tax expense included in cost of service is $350. If the DTA (a/c 190) is ignored for purposes of determining the quantity of ADIT by which to offset rate base, that offset amount would be $875. Consequently, the rate base offset ($875) would exceed the deferred tax expense included in cost of service ($350), a situation that, on its face, conflicts with the Normalization Rule requirement of consistency.

Treas. Reg. §1.167(l)-1(h)(2) provides that no specific bookkeeping is necessary to record an ADIT reserve required by the Normalization Rules so long as the amount of the reserve is identifiable. There is no reference to a single account. The strong implication is that all relevant accounts must be included in its computation. In terms of the limitation imposed by Treas. Reg. §1.167(l)-1(h)(1)(iii), this means that the ADIT reserve subject to the limitation is not restricted to Taxpayer's a/c 282 balance only. The two accounts (a/c 282 and a/c 190) together constitute the ADIT reserve for this purpose. Alternatively, the balance in a/c 282 reflects an amount that exceeds the tax deferred by virtue of claiming accelerated depreciation. In computing the limitation on the amount by which rate base can be reduced, the ADIT balance must be adjusted to conform to the requirements of the Normalization Rules – that is, it must be reduced by an amount equal to the balance in a/c 190.

More directly on point was the Service's recent holding in PLR 201418024. In that ruling, the Service held that the Normalization Rules required that the utility's NOLC-related DTA be "taken into account" by the utility's regulators in establishing rates. The way in which the regulators asserted that they "took it into account" was by imposing on customers a deferred tax charge on the entire difference between book and tax depreciation whether or not the deduction created an NOLC. Under those circumstances, the Service ruled that the DTA did not have to be included in the ADIT calculation because it had already been "taken into account" in computing tax expense. The type of ratemaking for the DTA claimed by the regulators in PLR 201418024 is not practiced (or even claimed to be practiced) by the regulators in Kentucky. In Taxpayer's context, if the NOLC-related DTA is not included in the calculation of rate base, then it is not "taken into account" at all, a consequence of which is that the treatment will be inconsistent with the Normalization Rules.

And even more recently, the Service addressed exactly this issue in PLRs 201436037, 201436038 and 201438003. In each of these rulings the Service ruled that, to the extent that the taxpayer's NOLC-related DTA was attributable to accelerated depreciation, it must be reflected in the computation of the ADIT balance by which rate base is reduced.

Requested Ruling #2.

By design, the Normalization Rules operate to effectively limit the discretion that regulators have with regard to the treatment of the benefits of accelerated depreciation and investment tax credits. As indicated above, the normalization restrictions only apply to the

extent that an NOLC is attributable to accelerated depreciation. Thus, a methodology for determining the amount of an NOLC that is attributable to accelerated depreciation will also determine the extent to which regulators do or do not have discretion with regard to the treatment of that NOLC. This is, obviously, of critical importance to all parties to Taxpayer's rate proceedings.

Treas. Reg. §1.167(l)-1(h)(1)(iii) appears to be the only authority that addresses attribution for purposes of the Normalization Rules. The structure of this provision bears close examination. The first sentence sets out a general rule that clearly requires a "last dollars deducted" measurement procedure for determining the tax deferred by virtue of claiming accelerated depreciation. Under this method, an NOLC is attributable to accelerated depreciation to the extent of the lesser of (1) the accelerated depreciation claimed or (2) the amount of the NOLC. In effect, all deductions other than accelerated depreciation are offset against available taxable income prior to considering accelerated depreciation. The second sentence of the regulation provides another general rule – this one a timing rule for "taking into account" the tax deferred and measured pursuant to the first sentence. The third sentence then prescribes a different rule where there is an NOLC. The question is whether this third sentence is intended to prescribe a different rule for the timing of recognition of the tax deferred or, alternatively, for the way in which the tax deferred is measured – or, perhaps, for both. All that can be said is that this sentence specifies no alternative measurement procedure. Further, it fails to describe why or

under what circumstances the general rule's "last dollars deducted" measurement procedure would be inappropriate.

In determining the portion of its NOLC (and, hence, its a/c 190 balance) that is attributable to accelerated depreciation subject to the Normalization Rules, Taxpayer presumed the "last dollars deducted" measurement methodology described in Treas. Reg. §1.167(l)-1(h)(1)(iii). Note that, for purposes of attributing excess deferred taxes to the items of deduction comprising an NOL carryback, the Service has twice ruled that the ratable allocation of such excess to all of the book-tax timing differences occurring in the NOL year is permissible under the Normalization Rules. *See* PLRs 8903080 and 9336010. Notwithstanding these PLRs, since Taxpayer has an NOLC and not an NOL carryback, it has presumed the "last dollars deducted" technique described in the regulations rather than the ratable allocation approach described in the two PLRs. In all cases, the "last dollars deducted" measurement methodology will attribute a larger amount of an NOLC to accelerated depreciation than would a "ratable allocation" approach. Thus, Requested Ruling #2 asks the Service to rule that the use of any method other than the "last dollars deducted" method would be inconsistent with the Normalization Rules.

The one certain aspect of Treas. Reg. §1.167(l)-1(h)(1)(iii) is that the Service has discretion in this area. One of the factors that should be relevant to the Service's determination as to the appropriate allocation method is the relationship between the necessity to allocate the NOL and the Normalization Rules. The fundamental question is whether the NOL allocation methodology represents an element of the Normalization Rules or, alternatively, is external to

them. If the NOL allocation process is itself an element of those rules, then it shares the specific Congressional purpose with those rules and should be viewed as a tool for accomplishing that purpose. Since the specific purpose of the Normalization Rules is to preserve the benefits of accelerated depreciation deductions to utilities, an allocation procedure that maximizes the preservation of those benefits would further that Congressional purpose. Further, any procedure that does not maximize the preservation of those benefits would not further the purpose. By contrast, if the NOL allocation process is external to the Normalization Rules, then it does not share that Congressional purpose. If that were the case, the NOL allocation should take place under general tax principles and any portion attributed to accelerated depreciation under that allocation should then be subject to the protective provisions of the Normalization Rules.

The necessity to allocate an NOL to accelerated depreciation is occasioned by the Normalization Rules and only those rules. Taxpayer is aware of no other reason under the tax law to perform this allocation. Thus, "but for" the Normalization Rules, this allocation would not be necessary. Therefore, the allocation process appears to be an element of those rules. Further, Taxpayer is not aware of any general tax principles governing the attribution of an NOL to a specific deduction which could be used to determine the amount to which the Normalization Rules apply (though there are a number of statutory attribution directives applicable to specific deductions which will be identified and described below).

There appear to be three main options available to the Service: it can conclude that the Normalization Rules accommodate any allocation methodology, that they do not require any single methodology but do impose a standard of some type or that they require a single, specified methodology.

Concluding that the Normalization Rules do not require any particular allocation methodology would be tantamount to a determination that the Normalization Rules do not apply to NOLCs. As a practical matter, the only limit this approach imposes would be in a situation where a taxpayer claims accelerated depreciation deductions in excess of its taxable revenues. Only then would at least some portion of the NOLC ***have*** to be attributed to accelerated depreciation. In all other cases, the NOLC could be attributed to other deductions and the Normalization Rules rendered inapplicable. Such a result would seem inconsistent with the Service's conclusion that the Normalization Rules do, in fact, apply to NOLCs as was indicated in PLRs 8903080 and 9336010 (which concluded that there was not unfettered discretion in allocating an NOL for purposes of the normalization rules), PLR 8818040 and, most especially, PLR 201418024.

Concluding that, while the Normalization Rules do impose a limitation on the allocation method used, more than one method may be permissible would provide regulatory discretion – though not unfettered discretion. If this were the case, there would need to be some very specific parameters provided to enable companies and regulators to distinguish between those methods that are permissible and those that are not. A failure to provide such parameters would create a

"We can't define it but we know it when we see it" situation. This would almost ensure that every allocation methodology proposed by a utility, its regulators or rate case intervenors would need to be vetted with the National Office before being implemented. A flood of PLR requests would likely result. The uncertainty inherent in this approach renders it a very undesirable solution and, ultimately, the IRS will still have to address the very same issue in a piecemeal fashion.

The adoption of a single, mandated allocation methodology should, depending on the specific method selected, avoid uncertainty and inconsistency. There appear to be three main allocation approaches available to the Service – "last dollars deducted", "first dollars deducted"[8] or some type of ratable allocation. Both the "first dollars deducted" and the "last dollars deducted" methodologies are simple, specific, transparent and would produce uniformity among taxpayers. Nothing other than "book" and tax depreciation would need to be quantified so that these methodologies would operate independently of financial accounting concepts and rules (aside from the concept of "book" depreciation – a well understood concept). These two methodologies would be difficult to manipulate so that it is highly likely that all taxpayers would be similarly treated. Finally, because the bases of computation ("book" and tax depreciation) used in these methodologies are so well understood, they would be resistant to controversy.

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[8] "First dollars deducted" refers to the method that treats accelerated depreciation deductions as being the first deductions applied against taxable income before considering any other deductions.

By contrast, a ratable allocation methodology inherently involves uncertainty – starting with the question of "ratable with regard to what?" The two PLRs that applied a ratable allocation methodology (PLRs 8903080 and 9336010) used all timing differences as the basis for allocation. An allocation on this basis is subject to uncertainty, variability and is based on questionable logic. Among the issues are:

1. There is no logical basis on which to distinguish between timing and permanent differences insofar as both have the same effect on taxable income;
2. Since there are both timing differences that increase (unfavorable) as well as decrease (favorable) taxable income, an allocation that is based on all timing differences requires both positive and negative allocations of an NOL – something that doesn't make inherent sense;
3. Even if the allocation is based only on favorable timing difference, there are favorable timing differences that relate to income items rather than deductions. An allocation to such a favorable timing item would be questionable since the purpose of the allocation is to distinguish between accelerated depreciation and other deductions;
4. If the allocation is based only on favorable timing differences or even only on favorable timing differences produced by deductions, the way in which a taxpayer nets or fails to net related favorable and unfavorable timing items can have a material impact on the result of the allocation. In other words, the

allocation can vary depending entirely on presentation – not economics – and different companies have different practices in this regard; and

5. If the financial or regulatory accounting rules change for an item, then the NOL allocation would change even though there is no change in the tax law.

Though an allocation based purely on tax deductions (rather than book/tax timing differences) would de-link completely from financial reporting concepts, it would come with its own set of issues. Among these are:

1. For a utility that generates electricity, many costs that would otherwise be deductions are, for tax purposes, reflected in cost of goods sold which, as a technical matter, is not a deduction but an offset against revenues in deriving gross income;[9] and
2. The Normalization Rules do not actually apply to a tax deduction but to a portion of a tax deduction - the excess of accelerated over regulatory depreciation. Thus, allocating an NOL between deductions will not, itself, produce an amount of the NOL that is subject to the Normalization Rules.

In short, a ratable allocation methodology is questionable from a simplicity, administrability and uniformity perspective.

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[9] Though Taxpayer is a gas utility, presumably whatever rule is applicable to it would be equally applicable to such a utility.

Returning to an evaluation of the two simpler options, "first dollars deducted" and "last dollars deducted", the choice between the two is relatively stark.

The "first dollars deducted" methodology minimizes the portion of any year's NOLC that is attributed to accelerated depreciation. In fact, using that methodology, the only time the normalization rules would impact the treatment of an NOLC is where a company's accelerated depreciation exceeds its taxable revenue for the year. This approach would clearly be inconsistent with the legislative intent of protecting the benefits of accelerated depreciation which underlies the Normalization Rules. Further, there is no instance of which Taxpayer is aware where a "first dollars deducted" approach is or has been used in a statute, regulation, ruling or other authority to determine the portion of an NOL attributable to any particular deduction.

By contrast, the "last dollars deducted" methodology maximizes the portion of an NOLC that is attributed to accelerated depreciation and, thus, this methodology appears most aligned with the purpose of the Normalization Rules. The tax benefits of accelerated depreciation will be protected to the extent accelerated depreciation was claimed. In fact, it is not unusual for the Code to employ a "last dollars deducted" approach to allocating an NOL to a specific tax deduction both where the deduction has been identified for especially beneficial treatment and, in one instance, where it has been identified for especially unfavorable treatment. The following

Code provisions all determine the portion of an NOL that is attributable to a specified deduction in this way:

1. Code §1212(a)(1)(C) – this section provides that the carryforward period for a capital loss carryover that is attributable to a foreign expropriation loss is 10 years instead of the normal 5 years;
2. Code §172(b)(1)(C) – this section provides that the carryback period for a specified liability loss is 10 years rather than the normal 2 years;
3. Code §172(b)(1)(D) – this section provides that the carryback period for the portion of an NOL that is attributable to the deduction for bad debts by a commercial bank is 10 years rather than the normal 2 years;
4. Code §172(b)(1)(E) – this section provides that a corporate equity reduction interest loss may not be carried back to the year preceding the year is which the corporate equity reduction transaction occurs;
5. Code §172(b)(1)(G) – this section provides that the carryback period for a farming loss is 5 years rather than the normal 2 years; and
6. Code §172(b)(1)(J) – this section provides that the carryback period for a qualified disaster loss is 5 years rather than the normal 2 years.

The common feature in all of these provisions is that, in each case, the statutory allocation methodology maximizes the NOL attributable to the identified deduction. Taxpayer has not

encountered a statutory provision that associates an NOL with specific deductions in any other way.

If, in fact, the NOL allocation is an element of the Normalization Rules, a "last dollars deducted" approach would be consistent with the policy underlying those rules. Further, the frequency - and uniformity - of Congress's use of a "last dollars deducted" approach whenever an NOL is to be allocated to a specific deduction strongly supports the propriety of that approach in a situation in which Congress has singled out accelerated depreciation for special treatment under the tax law. These considerations, coupled with the many positive administrative attributes of such an approach, support its application in this situation.

Finally, the Service addressed this very issue in PLRs 201436037, 201436038 and 201438003. In each of these rulings the Service ruled that, in determining the portion of an NOLC that is attributable to accelerated depreciation, any method other than the "with and without" method (the same as the "last dollars deducted" method) would be inconsistent with the Normalization Rules.

CONCLUSION

For the reasons set forth above, we respectfully request that the Service issue the rulings requested.

PROCEDURAL MATTERS

A. Statements required by Rev. Proc. 2014-1:

1. Section 7.01(4) –To the best of the knowledge of both Taxpayer and Taxpayer's representative, the issue that is the subject of this requested letter ruling is not addressed in any return of Taxpayer, a related taxpayer within the meaning of §267, or of a member of an affiliated group of which Taxpayer is also a member within the meaning of §1504 that is currently or was previously under examination, before Appeals, or before a Federal court.

2. Section 7.01(5)(a) – Taxpayer, a related party taxpayer within the meaning of §267, or a member of an affiliated group of which Taxpayer is also a member has not, to the best of the knowledge of both Taxpayer and Taxpayer's representative, received a ruling on the issue that is the subject of this requested letter ruling.

3. Section 7.01(5)(b) - To the best of the knowledge of Taxpayer and Taxpayer's representative, neither Taxpayer, a related taxpayer, a predecessor, nor any representatives previously submitted a request involving the same or a similar issue to the Service but with respect to which no letter ruling or determination letter was issued.

4. Section 7.01(5)(c) - To the best of the knowledge of Taxpayer and Taxpayer's representative, neither Taxpayer, a related taxpayer, nor a predecessor, previously submitted a request (including an application for change in method of accounting) involving the same or a similar issue that is currently pending with the Service.

5. Section 7.01(5)(d) – To the best of the knowledge of Taxpayer and Taxpayer's representative, neither Taxpayer nor a related taxpayer are presently submitting additional requests involving the same or a similar issue.

6. Section 7.01(8) - The law in connection with this request is uncertain and the issue is not adequately addressed by relevant authorities.

7. Section 7.01(9) - Taxpayer has included all supportive as well as all contrary authorities of which it is aware.

8. Section 7.01(10) - Taxpayer is unaware of any pending legislation that may affect the proposed transaction.

9. Section 7.02(5) - Taxpayer hereby requests that a copy of the ruling and any written requests for additional information be sent by facsimile transmission (in addition to being mailed) and hereby waives any disclosure violation resulting from such facsimile transmission. Please fax the ruling and any written requests to James I. Warren at (202) 626-5801.

10. Section 7.02(6) - Taxpayer respectfully requests a conference on the issues involved in this ruling request in the event the Service reaches a tentatively adverse conclusion.

11. Taxpayer will permit the KPSC to participate in any Associate office conference concerning this ruling request. Taxpayer has provided the KPSC with a copy of this ruling request prior to its being filed.

B. Administrative

1. The deletion statement and checklist required by Rev. Proc. 2014-1 are enclosed.

2. The required user fee of $19,000 is enclosed.

3. A Form 2848 Power of Attorney granting Taxpayer's representative the right to represent Taxpayer is enclosed.

If you have any questions or need additional information regarding this ruling request, pursuant to the enclosed Power of Attorney, please contact James I. Warren at (202) 626-5959.

Respectfully submitted,

James I. Warren
Miller & Chevalier Chartered
Attorney for Atmos Energy Corporation

PENALTIES OF PERJURY STATEMENT

Atmos Energy Corporation

Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the request contains all the relevant facts relating to the request, and such facts are true, correct, and complete.

Atmos Energy Corporation

BY:

____

DATE: _______________________________

DELETION STATEMENT

For purposes of Section 6110(c)(1) of the Internal Revenue Code of 1986, as amended, Taxpayer requests the deletion of all names, addresses, EINs, locations, dates, amounts, regulatory bodies and other taxpayer identifying information contained in the attached request for private letter ruling.

Taxpayer reserves the right to review, prior to disclosure to the public, any information related to this request for private letter ruling and to provide redacted copies of any documents to be released to the public.

Date: ______________________ ______________________

James I. Warren
Miller & Chevalier Chartered
Attorney for Atmos Energy Corporation

Language for KPSC letter:

On Letterhead:

By letter dated ____, Atmos Energy Company ("Atmos Energy") furnished to the Kentucky Public Service Commission ("KPSC") a copy of a request for a private letter ruling from the National Office of the Internal Revenue Service which seeks guidance regarding the application of the depreciation normalization rules of §168(i)(9) of the Internal Revenue Code of 1986 to the regulatory treatment of net operating loss carryovers.

We have reviewed the ruling request and believe that it is adequate and complete. Further, Atmos Energy has indicated that it will permit the KPSC to participate in any associate office conference concerning the ruling request.

If additional information is desired, please feel free to contact the undersigned.

Respectfully submitted,