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ORDER NO. 106

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Dan G. Blair, Chairman;
Mark Acton, Vice Chairman;
Ruth Y. Goldway;
Tony L. Hammond; and
Nanci E. Langley

Accounting Practices and Tax Rules for Competitive Products

Docket No. RM2008-5

ORDER PROPOSING ACCOUNTING PRACTICES AND TAX RULES FOR COMPETITIVE PRODUCTS

September 11, 2008

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(Issued September 11, 2008)

I. INTRODUCTION AND SUMMARY

The Postal Accountability and Enhancement Act (PAEA), Pub. L. 109-435, 120 Stat. 3218 (2006), requires the Commission to prescribe rules applicable to competitive products for the establishment and application of (a) the accounting practices and principles to be followed by the Postal Service, and (b) the substantive and procedural rules for determining the assumed Federal income tax on competitive products income. *See* 39 U.S.C. 2011(h)(2)(B). In addition, such rules shall provide for the submission by the Postal Service of annual and other periodic reports setting forth such information as the Commission may require. 39 U.S.C. 2011(h)(2)(B)(i)(III).

Aided by recommendations contained in a report submitted by the Secretary of the U.S. Department of Treasury (Treasury) pursuant to the PAEA, as well as comments on that report provided by interested persons, including the Postal Service, the Commission proposes rules for implementing section 2011(h)(2)(B). *See* sections II B and C, *infra.* By statute, such rules must be issued on or before December 19, 2008, unless the Commission and the Postal Service agree on a later date. *See* 39 U.S.C. 2011(h)(2)(B)(ii). Interested persons are invited to comment on the proposed rules. Comments are due no later than 30 days after publication in the *Federal Register.* Reply comments are due no later than 45 days after publication in the *Federal Register*.

Among the goals of the PAEA are the following: (1) increase the transparency of Postal Service operations; (2) prohibit cross-subsidies of competitive products by market dominant products; and (3) reduce administrative burdens. In developing the proposed rules, the Commission has been guided by these goals. The proposed rules attempt to give effect to section 2011 in the context of the PAEA as a whole, while recognizing the realities and complexities of the Postal Service's operations and the legitimate expectations of stakeholders.

The assumed Federal income tax is, in reality, an intra-agency transfer designed, it would appear, to foster fair competition, a goal also served by the PAEA's pricing provisions applicable to competitive products. *See* 39 U.S.C. 3633(a)(1)-(3). Collectively, these pricing provisions also protect mailers of market dominant products by requiring that each competitive product cover its attributable costs, and that competitive products as a whole make a reasonable contribution to institutional costs. They further preserve fair competition in markets in which the Postal Service competes by prohibiting cross-subsidies by market dominant products of competitive products. The statute requires the annual "payment" of an assumed Federal income tax from the competitive products fund to the general postal fund and the proposed rules are designed to give effect to that requirement.

To that end, the proposed rules, which for the most part are in accord with Treasury’s recommendations and draw from the Postal Service’s suggestions, are based on a theoretical, on paper only enterprise, do not require new accounting or data collection systems, maintain the Commission's existing definition of attributable cost, and provide the Postal Service optional means for calculating an assumed Federal income tax on competitive products income. They are, in short, intended to promote the goals of transparency and accountability without imposing undue burdens on the Postal Service.

II. LEGAL REQUIREMENTS REGARDING THE ACCOUNTING AND INCOME TAX RULES FOR COMPETITIVE PRODUCTS

Section 2011 sets forth financial provisions specific to competitive products, including creating a Competitive Products Fund and specifying the conditions under which it is to operate. In addition, section 2011 requires the Secretary of the Treasury to develop recommendations regarding accounting principles and tax rules applicable to competitive products. The Commission, upon receipt of those recommendations, must provide interested persons an opportunity to comment on the recommendations and thereafter must, by rule, provide for the establishment and application of accounting principles and tax rules to be followed by the Postal Service with respect to competitive products. Finally, section 2011 requires the Postal Service to file certain periodic reports with the Commission and Treasury. These various requirements are discussed below.

A. Competitive Products Fund

Section 2011 establishes the Competitive Products Fund (CPF) as a revolving fund in the Treasury of the United States. The CPF is generally available for receipt of revenues and payment of obligations associated with competitive products. Section 2011 also:

- Governs deposits of revenues and payment of costs (39 U.S.C. 2011(a)-(d));[1]
- Authorizes and places limits on borrowings (*id.* 2011(e)(1)-(4));[2]

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[1] Costs include costs attributable to competitive products and all other costs incurred by the Postal Service to the extent allocable to competitive products. *Id.* 2011(a)(2).

[2] The Postal Service is authorized to borrow money and to issue such obligations as it deems necessary to provide for competitive products, including, for example, entering into agreements establishing reserve, sinking, and other funds, regarding the use of revenue and receipts of the CPF, and such other matters as the Postal Service considers necessary to enhance the marketability of such obligations. *Id.* 2011(e)(1)-(2); *see also* 2011(e)(3)-(4) for terms and conditions applicable for such obligations.

- Requires payments on obligations (*id.* 2011(e)(5));[3]
- Accords the CPF the same Federal budgetary treatment as the Postal Service Fund (*id.* 2011(f)); and
- Requires judgments arising out of the provision of competitive products to be paid from the CPF (*id.* 2011(g)).

B. Treasury Report Recommendations

On December 19, 2007, as required by 39 U.S.C. 2011(h)(1), the Secretary of the Treasury submitted a report to the Commission containing recommendations concerning accounting principles and practices that should be followed by the Postal Service for identifying and valuing assets and liabilities associated with providing competitive products, and the substantive and procedural rules for determining an assumed Federal income tax on competitive products income.[4] Treasury discusses specific PAEA accounting and Competitive Products Enterprise income tax requirements, ultimately recommending an accounting approach that it believes "will best meet these requirements, including identifying and valuing the assets and liabilities for the CPF and determining the assumed federal income tax on the income of the CPF." *Id.* at 1. Treasury endorses the use of a simplified income tax calculation, while recognizing that the Commission will need to determine the optimum accounting approaches that the Postal Service should implement. *Id.* Treasury concludes its introductory comments to the report with the following cautionary observation:

> The accounting and income tax approaches described in this report should serve as the starting points for such future discussions and decisions. Given the size and scope of the [Postal Service's] operations as well as the complexity involved in meeting the PAEA accounting and other requirements, Treasury believes that any necessary changes to the

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[3] Funds for payments on obligations are restricted to revenues, receipts, and assets of competitive products. The total assets are the greater of (1) assets related to the provision of competitive products; or (2) the percentage of total Postal Service revenues and receipts from competitive products times the total assets of the Postal Service. *Id*. 2011(e)(5).

[4] Report of the U.S. Department of the Treasury on Accounting Principles and Practices for the Operation of the United States Postal Service's Competitive Products Fund, December 19, 2007 (Treasury Report).

> existing [Postal Service] costing and other systems should be made incrementally and notes that some may need to be implemented over the long term.

Id. at 1-2.

As relates to its task of developing recommendations, Treasury identifies five PAEA requirements applicable to competitive products:

- The prohibition against subsidies by market dominant products (sections 3633(a)(1) and 2011(h)(1)(A)(II));
- The requirement that each competitive product cover its attributable costs (section 3633(a)(2));
- The requirement that competitive products collectively cover what the Commission determines to be an appropriate share of the Postal Service's institutional costs (section 3633(a)(3));
- The obligation to annually compute an assumed Federal income tax on competitive products income (section 3634(b)(1)); and
- The requirement that total assets of the CPF shall be the greater of the assets related to the provision of competitive products calculated under section 2011(h) or the percentage of total Postal Service revenues and receipts from competitive products times the Postal Service's total assets (section 2011(e)(5)).

Id. at 31.

In developing its recommendations, Treasury discusses the Postal Service's current costing system, the cost accounting requirements for competitive products under the PAEA, and difficulties in calculating an assumed Federal income tax on competitive products income. In the end, based on its review of various legal, policy, and practical factors, Treasury offers nine specific recommendations as follows:

1. Modify the current cost attribution system to reflect competitive products as determined by the Commission;
2. Create a theoretical, on paper only competitive enterprise, assigning to it an appropriate share of total Postal Service costs;

3. Use currently reported volume variable or marginal costs to ensure that competitive products cover their attributable costs, and use reported incremental costs to guard against cross-subsidization of competitive products by market dominant products;

4. Adjust competitive products contribution to institutional costs, if necessary, once Universal Service Obligation costs have been reliably established;

5. Modify the current cost accounting system to capture the causal relationship between market dominant and competitive lines of business and their applicable business costs, with remaining costs treated as institutional;

6. Use existing financial data systems as basis for reporting competitive products profits with adjustments, as necessary, to determine the assumed Federal income tax;

7. Develop a theoretical competitive products income statement;

8. Calculate an assumed income tax using a simplified approach, preferably using a published, regularly updated tax rate; and

9. Provide sufficient accounting and financial statements regarding the theoretical competitive products enterprise.

Id. at 32-33.

C. Docket No. PI2008-2

To fulfill its obligations under section 2011(h)(2)(A), the Commission initiated Docket No. PI2008-2 to provide interested persons, including the Postal Service, an opportunity to comment on Treasury's recommendations.[5] In addition, the Commission solicited parties' comments on specific questions related to the Treasury Report.

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[5] PRC Order No. 56, Notice and Order Providing an Opportunity to Comment on Treasury Report, January 28, 2008 (Order No. 56).

Comments were submitted by the Postal Service,[6] United Parcel Service (UPS),[7] Pitney Bowes, Inc. (Pitney Bowes),[8] Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (Valpak),[9] Parcel Shippers Association (PSA),[10] and the Public Representative.[11] Reply comments were submitted by the Postal Service,[12] the Public Representative,[13] Parcel Shippers Association,[14] and Robert W. Mitchell.[15] The Commission appreciates the commenters' submissions. They have been helpful in developing the proposed rules.

The parties' specific comments are discussed below in connection with the proposed rules. In general, however, the comments are broadly consistent and supportive, in large part, of Treasury's recommendations.[16] While there are differences among the comments, there appears to be agreement that a theoretical, on paper only enterprise is the only viable construct; the current costing and financial reporting

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[6] Initial Comments of the United States Postal Service in Response to Order No. 56 and the Treasury Report, April 1, 2008 (Postal Service Comments).

[7] Comments of United Parcel Service on the Treasury Report, April 1, 2008 (UPS Comments).

[8] Comments of Pitney Bowes Inc. in Response to Notice and Order Providing and Opportunity to Comment on Treasury Report, April 1, 2008 (Pitney Bowes Comments).

[9] Valpak Direct Marketing Systems, Inc. and Valpak Dealer's Association, Inc. Initial Comments on Report of the U.S. Department of the Treasury on Accounting Principles and Practices for the Operations of the United States Postal; Service's Competitive Products Fund, April 1, 2008 (Valpak Comments).

[10] Comments of the Parcel Shippers Association on Treasury Report, April 1, 2008 (PSA Comments).

[11] Public Representative's Comments in Response to Commission Order No. 56, April 1, 2008 (Public Representative Comments).

[12] Reply Comments of the United States Postal Service in Response to Order No 56 and the Treasury Report, May 1, 2008 (Postal Service Reply Comments).

[13] Public Representative Reply Comments in Response to Commission Order No. 56, May 1, 2008 (Public Representative Reply Comments).

[14] Reply Comments of the Parcel Shippers Association on Treasury Report, May 1, 2008 (PSA Reply Comments).

[15] Reply Comments of Robert W. Mitchell, May 2, 2008 (Mitchell Reply Comments).

[16] As the Postal Service notes, no commenter expresses any material disagreement with the recommendations. Postal Service Reply Comments at 1.

systems are suitable as a basis for competitive product reporting purposes; and a simplified income tax approach is appropriate.[17]

D. Periodic Reports

Section 2011(h)(2)(B)(i)(III) provides for the submission of annual and other periodic reports containing such information as the Commission may require. Pursuant to this provision and consistent with Treasury's recommendation (No. 9), the Commission proposes, as part of this rulemaking, that the Postal Service submit the following annual periodic reports: Income Report, Financial Status Report, Identified Property and Equipment Assets Report, and Pro-forma Balance Sheet.[18] Details of the proposed reports are discussed in section V below. If, in the future, it appears that additional financial reporting may be necessary to preserve an appropriate level of transparency and accountability, the Commission will consider requiring additional reports.

By statute, these reports are also to be filed with Treasury and the Postal Service Office of the Inspector General. 39 U.S.C. 2011(h)(2)(D). In addition, and as a separate matter, the Postal Service is obligated to submit a report to Treasury concerning operation of the Competitive Products Fund, which shall address, *inter alia,* reserve balances, allocation or distribution of money, and liquidity requirements. *Id.* 2011(i)(1). While a copy of this report is to be filed with the Commission, the detailed reporting requirements are matters to be addressed by the Postal Service and Treasury.

III. ACCOUNTING PRACTICES AND PRINCIPLES

In developing its recommendations regarding the accounting practices and principles that should be followed by the Postal Service to identify and value assets and

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[17] *See, e.g.*, Valpak Comments at 3; Public Representative Comments at 4; and Pitney Bowes Comments at 3-4.

[18] The pro forma Balance Sheet is a hypothetical statement designed to provide information on the assets and liabilities of the hypothetical competitive products enterprise.

liabilities associated with providing competitive products, Treasury focuses on what it characterizes as the PAEA's cost accounting requirements, in particular, the requirements of section 3633(a). *See* Treasury Report at 3-10 which sets forth Treasury's recommendations 1 through 7. *See also id.* at 31.

The Commission's proposed rules regarding accounting practices and procedures associated with providing competitive products are similarly derived and focus on the costing methodology to be used by the Postal Service; methods for valuing assets and liabilities; and the financial reporting requirements for the competitive products enterprise. In this section, the Commission addresses the accounting principles embodied in the proposed rules and, as appropriate, Treasury's related recommendations and commenters' suggestions.

A. Competitive Products Fund

The PAEA requires a separate fund, the Competitive Products Fund, to be established for competitive products. The principal purpose of the Competitive Products Fund appears to be to ensure that expenses related to competitive products are not paid by market dominant products. The PAEA, which was implemented in December 2006, contemplates a two-year review period under section 2011 to implement the accounting practices and tax rules for determining the assumed Federal income tax on competitive products income. Although the proposed rules will not be effective prior to the end of FY 2008, the competitive products enterprise will, as proposed herein, be subject to the assumed income tax for that period. Given these timing differences, the Commission believes that, as a practical matter, the beginning balance of the Competitive Products Fund should reflect the contribution to institutional costs made by competitive products in FY 2007 that exceeded the 5.5 percent required by the rules.

Based on the FY 2007 Annual Compliance Determination, that amount was $49 million.[19]

B. Theoretical Enterprise

The Commission agrees with Treasury's conclusion that the

> only viable method to begin to address the PAEA requirements for competitive products is to establish a theoretical, regulatory reporting construct under which the [Postal Service] would 'on paper only' analytically segregate and identify the revenue and costs associated with the competitive products — that is, to treat competitive products as if they were sold by a separate, theoretical enterprise or corporation that shares economies of scale and scope with the market-dominant products.

Treasury Report at 4.

The Commission accepts Treasury's recommendation (*id*. at 7) that a theoretical enterprise be analytically created by assigning it an appropriate share of all Postal Service costs. As Treasury points out and no commenter disputes, if this assumption is not made, then sophisticated cost modeling of a true stand-alone enterprise would be required, an undertaking that would be costly and necessitate numerous assumptions that would be difficult to validate. *Id.* at 6.

Adopting the virtual enterprise means that financial reporting related to competitive products will derive from the accounting and data collection systems used for all postal services. While refinements may be necessary to account for all activities related to competitive products, it would not be economical to require the Postal Service to construct entirely new systems solely for competitive products. Just as economies of scope can derive from shared equipment and facilities, so can economies of scope derive from shared accounting systems. As long as existing systems can be adjusted to

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[19] *See* PRC Annual Compliance Determination, U.S. Postal Service Performance Fiscal Year 2007, March 27, 2008, Table IV-A-1 at 24. The $49 million is calculated as the total contribution to institutional costs of competitive products ($1,785.9 million) less 5.5 percent of the total institutional costs of the Postal Service of $31,577.12 million ($1,785.9-($31,577.2 * .055) = $49.1).

generate complete and accurate information concerning competitive products, using existing systems is more economical.

C. Attributable Costs

Treasury states that "[t]he volume-variable or marginal product costs reported by the [Postal Service] cost system should be used — after the product definition modification required by PAEA — to ensure that the competitive products cover their attributable costs." *Id.* at 7. This description of attributable costs differs from that traditionally used by the Commission which includes both product specific and volume variable costs. In reply comments, Mitchell proposes that the Commission remove product specific costs from attributable costs. He contends that these costs will be captured in incremental costs. He reserves the term "attributable" for volume-variable costs alone. Mitchell Reply Comments at 9 and 10.

The Commission does not accept Treasury's or Mitchell's definition that equates volume variable costs with attributable costs because it is at odds with the Commission's long-held and judicially approved treatment of attributable costs.[20] The PAEA, which codifies the Commission's definition, defines "cost attributable" to mean "the direct and indirect postal costs attributable to such product through reliably identified causal relationships." 39 U.S.C. 3631(b). The Commission attributes product-specific costs because a causal relationship can be established between these costs and the products they are associated with. Accordingly, the proposed rules are based on the Commission's long-held definition of attributable costs, which forms the basis for determining compliance with section 3633(a)(2), the requirement that each competitive product covers its attributable costs.

Valpak, Pitney Bowes, and UPS contend that improvements should be made to attributable cost measurement by the Postal Service to more accurately measure

[20] *National Association of Greeting Card Publishers v. United States Postal Service*, 462 U.S. 810, 830 (1983).

competitive products costs and to prevent cross-subsidization of competitive products by market dominant products. Valpak Comments at 4-6; UPS Comments at 2-3; and Pitney Bowes Comments at 2-4. The Commission agrees that the current costing system should be improved to the extent practicable to reflect new products, and used as the basis for the attribution of costs to competitive products.

Regarding data validity, Valpak states that the Commission may want to consider establishing minimal acceptable limits for reliability and require the Postal Service to meet those limits. While the Commission agrees with commenters that accurate cost data are essential, it refrains from prescribing specific data validation at this time. Should data quality issues arise the Commission may, at its discretion, or at the request of an interested party, initiate proceedings to address these issues. *See* 39 U.S.C. 2011(h)(2)(c)(ii).

D. Cost Nomenclature

Treasury describes what it terms "line of business" costs as those costs incurred by providing a particular type or line of business, *i.e.*, competitive products or market dominant products. Treasury Report at 9. The Postal Service equates these costs with group specific costs, which it defines as "costs that are caused by the group of competitive products[.]" Postal Service Comments at 12; *see also id.* at 30. Illustratively, it uses the example of a manager responsible for a particular business line, *i.e.*, competitive products. *Id.* at 31-32. This manager's salary and benefits plus those costs for any support staff would be included as "line of business" costs and be borne by competitive products as a group. The Postal Service describes the remaining costs as "enterprise sustaining" costs, *i.e.* costs not associated with any individual line of business but generated in sustaining all lines of business. The Postmaster General's salary and benefits are an example of such costs. *Id*. at 29-37. The Commission concludes that "line of business costs" are the same as group specific costs and "enterprise sustaining" costs are the same as institutional costs.

E. Incremental Costs

Treasury defines incremental costs in the following manner:

> In a multi-product firm like [the Postal Service], incremental cost is the amount of cost avoided by eliminating a given product. The average incremental cost is this dollar figure divided by the number of units that are no longer produced. It is also possible to compute incremental cost by looking at the additional cost of adding a given number of units of a new product to the product line. However, the standard incremental cost calculation is based on the total cost that would be avoided if the current output of a product were reduced to zero and all associated costs with producing the product were eliminated.

Treasury Report at 39; *see also id.* at 3.

Section 3633(a)(1) prohibits cross-subsidies of competitive products by market dominant products. To test for cross-subsidies, Treasury recommends that competitive products reported incremental costs be used; *i.e.*, that such costs must be less than competitive products revenues. *Id.* at 32; *see also id.* at 7. Treasury's statements on this issue are somewhat ambiguous. On the one hand, it suggests that the incremental cost test should apply to each competitive product. *Id.* at 7. On the other hand, it states that "reported incremental costs should be used to ensure that cross-subsidization of the competitive products by market-dominant products is not occurring." *Id.*

Five parties address the issue of the appropriate application of the incremental cost test. Valpak and UPS suggest the incremental cost test should be applied to both individual competitive products and the competitive products enterprise as a whole. Valpak Comments at 7; UPS Comments at 2. Alternatively, Mitchell recommends that the Postal Service develop an estimate of the incremental cost of competitive products as a group, including any product specific costs. Mitchell Reply Comments at 10.

The application of the incremental cost test is a settled issue. In Docket No. RM2007-1, the Commission interpreted section 3633(a)(1) to mean that incremental costs apply to competitive products as a group, not to individual competitive products. *See* 39 CFR 3015.7(b). The Postal Service and Pitney Bowes concur with this interpretation. Postal Service Comments at 35; Pitney Bowes Comments at 7. In

Docket No. RM2008-4, the Commission proposes rules to require the Postal Service to file the relevant incremental cost data so that the incremental cost test can be applied.

F. Contribution to Institutional Costs

In addition to the incremental cost test, the PAEA requires that revenues from competitive products make an appropriate contribution to institutional costs, as determined by the Commission. 39 U.S.C. 3633(a)(3).[21] Treasury addresses this requirement in two respects. Following its discussion of group specific (or line of business) costs, Treasury recommends that the unassigned costs be treated as institutional costs and that an appropriate share of such costs should be covered by the theoretical competitive enterprise. Treasury Report at 6.

In addition, Treasury discusses the costs associated with the Postal Service's Universal Service Obligation (USO) and the degree to which such costs should be borne by competitive products. Among other things, Treasury comments that the USO may impose additional costs on the Postal Service that would not be incurred otherwise and that, as a general rule, USO costs are allocated solely to market dominant products. *Id.* at 7-8. Treasury further points out that economies of scope between competitive and market dominant products serve to reduce USO costs. *Id.* at 8.[22] It notes the pendency of the Commission's report on the USO and recommends that once

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[21] In Docket No. RM2007-1, the Commission set the appropriate share at 5.5 percent. PRC Order No. 43, Order Establishing Ratemaking Regulations for Market Dominant Competitive Products, October 29, 2007, at 90-92.

[22] Regarding the Commission's implementation of the PAEA, including sections 2011 and 3634, the Public Representative emphasizes that the continued existence of universal service is of paramount importance. Public Representative Comments at 3.

the USO costs have been reliably determined, the Commission should adjust the allocation of institutional costs to competitive products as may be appropriate.[23] *Id*. at 8.

Several parties comment on the appropriate allocation of institutional costs. PSA, which agrees with Treasury's recommendation regarding USO costs, also endorses Treasury's recommendation that unassigned costs be treated as institutional costs with an appropriate share allocated to competitive products. PSA Comments at 5. It suggests, however, that the Commission may wish to revisit that issue once various modifications required by the PAEA have been made to the Postal Service's costing systems. *Id.* at 5, 11.[24]

Pitney Bowes likewise endorses Treasury's recommendation to capture group-specific (or incremental) costs that are incurred by market dominant or competitive products. Pitney Bowes Comments at 7. It suggests that modifications to the costing systems "could result in noncompliance with the appropriate share requirement as currently established." *Id.* If that were to happen, it believes that the Commission should review the appropriateness of the 5.5 percent. *Id.* 7-8.

It is premature for the Commission to act on any of these suggestions. The Commission will, as appropriate, take its findings on the USO study into account with respect to its obligations under sections 3633(a)(3) and 3622(b)(9). *See* Valpak Comments at 5.

[23] In Order No. 56, the Commission asked whether its determination of an appropriate share of institutional costs under section 3633(a)(3) also satisfies, at least implicitly, the objective of section 3622(b)(9) (that institutional costs be allocated appropriately between market dominant and competitive products). PRC Order No. 56, Notice and Order Providing an Opportunity to Comment on Treasury Report, January 28, 2008, at 12. The two parties to address this question, the Postal Service and Valpak, equate the two provisions. Postal Service Comments at 37-38; Valpak Comments at 8.

[24] PSA also asserts (and the Commission agrees) that the assumed Federal income tax will have no effect on whether competitive products meet the requirements of section 3633(a)(3) since the tax applies only to amounts in excess of the required 5.5 percent share. PSA Reply Comments at 3, n.6.

G. Valuation of Assets and Liabilities

1. Assets

Section 2011(h)(1)(A)(i)(I) requires Treasury to make recommendations regarding accounting practices that should be followed by the Postal Service in identifying and valuing the assets and liabilities associated with competitive products. Treasury observes that "[e]fforts to analyze each [Postal Service] asset to determine its theoretical enterprise origin and usage could be a significant undertaking." Treasury Report at 26. It indicates, however, that the separation of assets could be achieved using cost drivers currently employed by the Postal Service to record depreciation and other expenses. *Id.* While not intended as exhaustive, Treasury discusses four potential methods for assigning assets to a theoretical competitive products enterprise. Two methods involve analyzing each individual asset and assigning it to competitive products based on an appropriate usage factor.[25] The other two methods use either a cost of revenue ratio, which distributes assets based on attributable costs, or a total revenue ratio, which distributes assets on the basis of total revenue. *Id.* at 26-27. While Treasury makes no specific recommendations, it notes that the simplicity of the latter two methods makes them an attractive option for the "greater of" test.[26]

In its initial comments, the Postal Service notes that "there are few, if any, physical assets *strictly identifiable* with competitive products at this point in time." Postal Service Comments at 17 (emphasis in original). To address this problem, the Postal Service proposes to provide an Annual Identified Property and Equipment Report, which would provide a listing and valuation of assets uniquely associated with providing competitive products. This listing would be limited to "*those cases where the*

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[25] Both of these methods would necessitate establishing a set of accounting books to monitor and track assignment for ongoing maintenance, including asset additions and/or reductions, associated with competitive products. *Id.*

[26] *Id.* at 27 regarding section 2011(e)(5)(A) and (B).

Postal Service chooses to establish separate operational or administrative units devoted solely to competitive products." *Id.* at 17-18 (emphasis in original).

The Commission concurs with Treasury that the cost of requiring the Postal Service to analyze each individual asset separately to determine its theoretical enterprise origin and usage would significantly outweigh any potential tax or other benefit. Such an assignment is not required under section 2011. The Commission agrees with Treasury that market dominant and competitive assets can be reasonably separated for purposes of section 2011 using cost drivers the Postal Service currently uses for reporting depreciation and other expenses. The Commission concludes that a simplified method similar to Treasury's suggested cost of revenue method will provide an appropriate comparison for the "greater of" test. This simplified method would not appear to be too burdensome or costly since it would basically follow the attribution of costs among products and thus would not require a significant asset analysis by the Postal Service to identify many of the asset accounts in the chart of accounts that would apply either partially or fully to the provision of competitive products. Moreover, as the Postal Service recognizes, a simplified approach is appropriate under section 2011. *Id.* at 41.

To assess the merits of the simplified method, the Commission, using the Postal Service's FY 2007 Annual Compliance Report (ACR) and the September, FY 2007 National Consolidated Trial Balance, assigned over $2.1 billion of assets to the theoretical competitive products enterprise. The following is illustrative of the Commission's analysis.[27]

The Cost Segments and Components report provides depreciation costs for Mail Processing Equipment, Motor Vehicles, Buildings, and Leasehold Improvements attributed to the products. Major property assets can be assigned to the competitive products enterprise using the ratio of depreciation costs attributed to competitive products to total depreciation costs. Furthermore, under the reasonable assumption

[27] Worksheets supporting the allocation analysis are in Library Reference 1, Commission allocation of USPS Assets and Liabilities at tab "assets."

that revenues from the sales of particular products will generate either cash or a receivable account, which will eventually become cash, many of the current assets—such as the cash and cash equivalents and accounts receivables—could be allocated to competitive products using the ratio of competitive products revenues to total revenues. The assets for supplies, advances, and prepayments can be assigned using cost drivers derived from the expense accounts for those assets.

Additionally, there are several asset accounts described in the Postal Service's chart of accounts devoted exclusively to competitive products.[28] These assets would be wholly assigned to competitive products.

2. Liabilities

Treasury notes that many of the same assignment techniques used to allocate assets would also be applicable to liabilities. Treasury Report at 26. For example, the current liability accrued compensation and benefits could be partially assigned to competitive products using the ratio of competitive products labor costs to total attributable labor costs. A minimal amount of analysis of the liability accounts for payables and customer deposit accounts would be needed to determine the liability accounts that are specific to competitive products.[29] Some non-current liabilities could also be allocated to competitive products using the applicable attributable costs as a basis for the distribution key (*e.g.*, workers' compensation, repriced annual leave, and leasehold improvements depreciation costs).

Using the FY 2007 ACR and the FY 2007 National Consolidated Trial Balance, the Commission was able to estimate over $1.8 billion of liabilities for competitive products.[30]

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[28] For example, account 13264 is Foreign Country Receivable—International Express Mail and is used to record receivables from foreign countries for International Express Mail.

[29] One such account that would be specific to competitive products would be account number 25311.055, Expedited Mail Advance Deposit.

[30] Worksheets supporting the allocation analysis are in Library Reference 1, Commission allocation of USPS assets and Liabilities at tab "liabilities."

While the proposed rules will require the production and filing of a balance sheet for competitive products, the methodology for assigning assets and liabilities is not specified therein. *See* proposed rules 3060.14 and 3060. 30. The methods used to develop the Commission's estimates are illustrative. Nonetheless, these methods are reasonably related to relevant cost drivers. Any method employed by the Postal Service should be as well and must be based on the same costing methodology used to produce the report required by 39 CFR part 3050. Additionally, the proposed rules provide the Postal Service 12 months to develop an analysis of the asset and liability accounts in the general ledger to be able to formulate a logical and reasonably accurate assignment methodology.

IV. CALCULATION OF AN ASSUMED FEDERAL INCOME TAX

The PAEA requires the Postal Service to calculate an assumed Federal income tax on competitive products income. Section 2011(h) provides minimal guidance as to how that assumed Federal income tax should be computed. It directs the Commission to "provide for the establishment and application of the substantive and procedural rules" to be followed in determining the annual assumed Federal income tax on competitive products within the meaning of section 3634. 39 U.S.C. 2011(h)(2)(B)(i)(II).

Section 3634 outlines the basis for calculating an assumed Federal income tax. First, it defines the term "assumed Federal income tax on competitive products income" to mean "the net income tax that would be imposed by chapter 1 of the Internal Revenue Code of 1986 (IRC) on the Postal Service's assumed taxable income from competitive products for the year[.]" 39 U.S.C. 3634(a)(1). Second, it defines the term "assumed taxable income from competitive products" to mean:

> the amount representing what would be the taxable income of a corporation under the Internal Revenue Code of 1986 for the year, if—
>
> (A) the only activities of such corporation were the activities of the Postal Service allocable under section 2011(h) to competitive products; and
>
> (B) the only assets held by such corporation were the assets of the Postal Service allocable under section 2011(h) to such activities.

Id. 3634(a)(2).

Finally, it requires the assumed tax be "paid," *i.e.*, transferred from the Competitive Products Fund to the Postal Service Fund, on or before January 15 of the next subsequent year. *Id.* 3634(b)-(c).

What follows is a discussion of the concepts the Commission believes are pertinent to the establishment and application of the substantive and procedural rules that should govern the assumed Federal income tax for the theoretical competitive products enterprise.

A. Appropriate Methods of Calculating Tax

In section 2 of its report, Treasury discusses numerous considerations that influence the calculation of an assumed Federal income tax on competitive products income. Treasury Report at 11-23. It identifies two approaches, complex and simplified, that could be used for this purpose, but notes that they differ "greatly in the cost, effort, and method of application." *Id.* at 24. Moreover, although it endorses a simplified approach, Treasury cautions that that approach, in particular, "would require some level of PAEA intent interpretation and scope determination by the appropriate governance bodies." *Id.*

Treasury discusses three methods to arrive at a "simple" assumed tax rate. First, Treasury states that the Postal Service could use the effective C corporation tax rate (currently a maximum of 35 percent) and apply it to competitive products pretax income. Treasury states that this approach would put the Postal Service at a disadvantage because it is unlikely that any of its competitors would ever pay taxes based on that effective tax rate. Second, Treasury discusses that the Postal Service could select a set of competitive firms in the private sector that publish their effective tax rates, determine their weighted average tax rate, and pay that rate. Treasury points out that finding a sample of corporations that would be truly comparable to the Postal Service would be very problematic. Third, Treasury states that the Postal Service could use as an assumed set tax rate the Congressional Research Service's most currently reported average effective tax rate for C corporations (*e.g.*, 26.3 percent for 1993-2002). *Id.* at 21-23.

No commenter disagrees with Treasury's recommendation that a simplified approach may be used to calculate the assumed Federal income tax of the competitive products enterprise. *See* Postal Service Comments at 14; Public Representative Comments at 11; UPS Comments at 4; and PSA Reply Comments at 3.

The Commission agrees that a simplified approach may be used. That approach, however, must adhere to section 3634(a), which defines the assumed tax to be "the net income that would be imposed by chapter 1 of the Internal Revenue Code of 1986[.]" The simplified approach recommended by Treasury, which is based on a Congressional Research Service (CRS) composite figure, would not appear to satisfy the statutory definition.[31] The simplified approach proposed by the Commission applies the effective C corporation tax rate to the competitive products enterprise's pretax income. *See* proposed rule 3060.40. Treasury characterizes this approach as viable, but notes it "puts the [competitive products] enterprise at an income disadvantage [because] … very few C corporations actually pay the effective tax rate." Treasury Report at 22. While it may be true that few C corporations actually pay the effective tax rate, the assumed Federal income tax "paid" by the theoretical competitive products enterprise is simply an intra-agency transfer from the Competitive Products Fund to the Postal Service Fund. Thus, any "income disadvantage" under this approach is more perceived than real.[32]

In lieu of simply applying the effective C corporations' tax rate to the theoretical competitive products enterprise pretax income, the Postal Service may elect, under the proposed rules, to avail itself of various deductions and/or credits under chapter 1 of the IRC. *See* proposed rule 3060.40. This option is available to the extent the Postal Service wishes to use it to reduce the competitive products enterprise assumed Federal income tax. However, because the assumed tax is merely an intra-agency transfer, the Postal Service lacks the same incentives as private industry, to minimize its tax payment.

While the Commission is cognizant of concerns over imposing unnecessary burdens on the Postal Service, it does not believe that using either of these approaches

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[31] Despite efforts, the Commission was unable to verify the CRS results or to determine how often they may be updated.

[32] Moreover, using either of the other simplified approaches suggested by Treasury would not be without tradeoffs. Using a composite effective tax rate, whether derived from competitors or the CRS, would likely require making adjustments for many tax treatments elected by private companies. For example, the Postal Service is not subject to foreign, state, or local taxes. Thus, using a composite effective tax rate could be viewed as giving the theoretical enterprise an "income advantage."

to calculate the assumed Federal income tax would be too burdensome or costly. The complexity of computing the appropriate tax rate and income tax due for the theoretical competitive products enterprise under chapter 1 of the IRC is largely determined by the specific tax treatments the Postal Service chooses to apply. The Postal Service may make adjustments to competitive products taxable income and assumed taxes due by availing itself of certain deductions and/or credits available under chapter 1 of the IRC. Yet taking some of these available deductions and credits to reduce taxable income or taxes due is optional. The Postal Service may choose to take any or all appropriate deductions and/or credits under chapter 1 of the IRC; however, the costs of attempting to reduce the transfer payment must be weighed against the benefits. *See* PSA Reply Comments at 3, suggesting that any expenditure to reduce the assumed tax payment would represent a net loss to the Postal Service.

B. Specific Issues Concerning the Competitive Products Tax Liability

Treasury states, "[t]ax law requires detailed accounting data for revenue and cost accruals/deferrals and asset-type specific depreciation methods in order to determine their applicability for tax treatment." Treasury Report at 27.

However, because the assumed Federal income tax is an intra-agency transfer and not an actual tax payment, certain simplifying assumptions and calculations can be made that will lessen the burden for the Postal Service while promoting fairness among the Postal Service and its competitors. Specific recommendations regarding tax issues are discussed below.

Timing of the competitive products enterprise taxes. The question of timing arises in two contexts. First, what "year end" should be applied each year for purposes of computing the assumed Federal income tax for competitive products and transferring that tax amount, if any, to the Postal Service Fund? Second, in what year should the first assumed Federal income tax be calculated for the competitive products enterprise.

Year end should be Postal Service fiscal year end September 30. Chapter 1 of the IRC allows a domestic C corporation to use any year end it chooses. 26 U.S.C.

441(b) and (e). Viewing the competitive products enterprise as akin to a domestic C corporation and given that the Postal Service's annual financial statements are provided on a September 30 fiscal year basis, the competitive products enterprise income tax return should be prepared on a September 30 year-end basis as well. Using this approach meets the requirement of the computation of an assumed Federal income tax under the PAEA while maximizing efficiency and minimizing costs for the Postal Service. No re-configuring of data related to non-conforming year ends is needed to compute the assumed Federal income tax. In addition, this approach is consistent with the statutory requirement that the transfer of the assumed Federal income tax, if any, from the Competitive Products Fund to the Postal Service Fund is due by January 15 following the close of the tax year (fiscal year end September 30). 39 U.S.C. 3634(c).

First fiscal year should be 2008. Section 3634 states that "[t]he Postal Service shall, for each year beginning with the year in which occurs the deadline for the Postal Service's first report to the Postal Regulatory Commission under section 3652(a) . . . compute its assumed Federal income tax on competitive products income for such year … 39 U.S.C. 3634(b). Section 3652 provides that the Postal Service must provide annual reports on costs, revenues, rates, and service to the Commission "no later than 90 days after the end of each year[.]" 39 U.S.C. 3652. The Postal Service voluntarily submitted its first annual report (for fiscal year 2007) under 39 U.S.C. 3652 on December 28, 2007. It follows that the first assumed Federal income tax computation must be made by the Postal Service for fiscal year ending September 30, 2008.

This would mean that according to 39 U.S.C. 3634(c), the transfer of the competitive products income tax due, if any, would have to be made by January 15, 2009. However, as explained above, the Commission expects final rules for the assumed Federal income tax computation to be completed no earlier than December 19, 2008. Therefore, a January 15, 2009 deadline does not appear to be reasonable. Hence, a one-time 6-month extension for computing and transferring the assumed Federal income tax will be allowed for the fiscal year ending September 30, 2008, which means that the computation and transfer must be completed by July 15, 2009.

The computation and transfer for the assumed Federal income tax for fiscal year ending September 30, 2009 will be due on January 15, 2010.

Assuming that fiscal year 2008 is the first year of the tax computation for the theoretical competitive products enterprise and transfer payment to the Postal Service Fund, the issue arises as to whether income deferred from fiscal year 2007 relative to competitive products activities should be included in the theoretical competitive products enterprise taxable income. In order to match income and expenses for a given year, the Commission believes that the income deferred from fiscal year 2007 should not be included in the tax computation for fiscal year 2008. Therefore, the Commission recommends backing out of income for fiscal year 2007 deferrals related to competitive products.

A similar issue arises with regard to deferred gains on installment sales of real estate. The Commission believes that this income should not be included in the tax computation for the theoretical competitive products enterprise for fiscal year 2008. The Postal Service should also back out those amounts of taxable income related to competitive products for any taxable year that sales proceeds were collected.

No quarterly estimated taxes. A domestic corporation would normally be required to pay estimated taxes on its projected income four times a year. 26 U.S.C. 6655. The complexity of accurately estimating such quarterly estimated corporate tax payments involves considerable time, effort, and cost. From the Commission's point of view, the PAEA's explicit requirement of a January 15 transfer of the assumed Federal income tax from the Competitive Products Fund to the Postal Service Fund (without requiring any other payment or transfer in the statute) indicates that quarterly payments were not intended by the drafters of the legislation. Also, since 26 U.S.C. 6655 requires quarterly tax payments for corporations is not in chapter 1 but in chapter 68 of the IRC, and the PAEA requires computing the hypothetical competitive products income tax under chapter 1 of the IRC, estimated tax payments and their related computations are not actually required under the PAEA. Hence, no computation or payment of estimated taxes is required.

No state, local, and foreign taxes. It is apparent that under 39 U.S.C. 3634 only the computation and transfer of an assumed "Federal" income tax by the Postal Service is required. In fact, section 3634 is titled "Assumed Federal income tax on competitive products income." The Postal Service will not be required to make a transfer payment from the Competitive Products Fund to the Postal Service Fund for state, local, or any foreign taxes.[33] Consequently, no deduction or credit for any assumed foreign, state, or local tax will be available to the Postal Service.

Net operating losses. Chapter 1 of the IRC permits a Net Operating Loss (NOL) to be carried back two years and forward 20 years. 26 U.S.C. 172(b). A carryback of a competitive products NOL resulting in the refund of previously transferred tax remittances to the Postal Service Fund will be allowed and should not be viewed as a prohibited cross-subsidy by market dominant products of competitive products. It should instead be seen as the same type of tax treatment any Postal Service competitor would be permitted to claim under chapter 1 of the IRC.[34] 26 U.S.C. 172. In its comments, Valpak specifically supports the carryforward of a NOL for competitive products. It states, "[t]o the extent that competitive products share in any reported loss by the Postal Service as a whole … no income tax should be payable, and losses reported for the Competitive Products Fund should have the same carry-forward privilege as in the private sector." Valpak Comments at 8. The Commission concludes that a two-year carryback and a 20-year carryforward of NOLs per chapter 1 of the IRC

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[33] *See also Federal Trade Commission's Accounting for Laws that Apply Differently to the USPS and its Private Competitors*, December 2007, p. 26.

[34] The following example is illustrative of the possible use of NOLs for the theoretical competitive products enterprise tax liability computation: In fiscal year 2008 and 2009, the competitive products enterprise earned $150,000,000 in taxable income and transferred $40,000,000 in assumed Federal income tax from the Competitive Products Fund to the Postal Service Fund. Then in 2010 the competitive products enterprise registered a loss of $60,000,000. A $60,000,000 NOL carryover would be appropriate and should not be viewed as a cross-subsidy by market dominant products of competitive products, since the carryback would not exceed the total income reported. This would be the same tax treatment that would be available to any regular domestic corporation under section 172 of chapter 1 of the Internal Revenue Code. Only if losses exceeded the past or future income would a refund not be appropriate.

are permissible. It should be noted, however, that the two-year carryback is optional and may be waived by the Postal Service under 26 U.S.C. 172(b)(3).

Accrual method. The accrual method of tax accounting is the appropriate method to be used for the theoretical competitive products enterprise because of the level of gross receipts it generates and the activities it performs. Generally, the cash method of accounting for tax purposes is only available to entities that generate less than $5 million in gross revenue. 26 U.S.C. 448. Competitive products generated almost $8 billion in gross revenue in fiscal year 2007.[35] Using the accrual method will also conform to the Postal Service's current financial accounting method, [36] which would minimize any necessary changes to the existing cost systems.

Elections for competitive products. The Commission agrees with Treasury that certain first-year and other elections should be deemed to have been made for the theoretical competitive products enterprise including recurring item exception, rotable spare part treatment for supplies and repairs,[37] section 266 election for capitalizing interest expense related to construction, and the election to defer revenue from services to be performed the next year according to Revenue Procedure 2004-34. Treasury Report at 23.

Deductions available to competitive products. The Commission discusses below selected deductions that may be available to the Postal Service with regard to competitive products. Other deductions may also be available. Their omission from the following discussion does not preclude the Postal Service from adopting them if appropriate. The Postal Service may elect to forgo deductions and apply the applicable tax rate under the IRC to its net income instead.

[35] It should be noted that while the activities performed by the theoretical competitive products enterprise are primarily services, they are not *personal* services as defined in Treasury Regulation 1.448-1T(e)(4) (law, accounting, health, engineering, architecture, actuarial, performing arts or consulting).

[36] United States Postal Service Annual Report 2007, Note 2, at 44.

[37] *See id*. at 44.

Adjustments for depreciation of assets. The tax law pursuant to 26 U.S.C. 362 would normally require the basis of contributed assets to a business organization to be computed on a tax basis.[38] However, the re-computation of depreciation for Postal Service assets assigned to the competitive products enterprise could be extremely complex, costly, and burdensome. The Commission concludes that for simplicity purposes, the competitive products assets deemed to be transferred to the theoretical competitive products enterprise should be considered to be transferred at their book basis (original cost plus improvements net of financial/cost accounting depreciation). Therefore, the Commission recommends that for all assets placed into service prior to October 1, 2007, the historical basis, in conformance with the existing Postal Service cost accounting system, should be used. Future depreciation of those assets put into service prior to October 1, 2007, and any subsequent sales gain or loss computation of those assets should be at their historical cost and in conformance with the existing financial accounting depreciation basis. The allowable depreciation for these assets for tax purposes will be captured in the attributable costs of competitive products. For assets placed in service beginning on or after October 1, 2007, tax depreciation in accordance with the IRC may be used.

Leasehold improvements placed in service after December 31, 1986 by a lessee should be depreciable over the life of the real estate that they have improved which generally means either 31-1/2 years or 39 years. When a lease terminates, whatever adjusted basis is remaining may be written off at that time. If the improvements were made before 1987, then the shorter of the lease term or the useful life of the property is the depreciation term. For simplicity purposes, the Commission believes that it would be appropriate for the financial statement amortization of leasehold improvements to be deductible for tax purposes as long as the assets were placed in service before October 1, 2007. Any leasehold improvements placed in service on or after October 1, 2007 should be depreciated according to the IRC.

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[38] The tax basis would be the original cost of the assets less the depreciation taken for tax purposes in previous years. Tax depreciation is normally greater than book depreciation.

For tax purposes, the theoretical competitive products enterprise should not be viewed as a government entity, but as a regular taxable corporate entity. Therefore, assets allocated to the theoretical competitive products enterprise should not be considered government property, which would normally be subject to section 168(g)'s slower and longer depreciation method.

Alternative minimum tax. Because the Alternative Minimum Tax (AMT) sections[39] are part of chapter 1 of the IRC, the AMT and the Adjusted Current Earnings (ACE) subsystem[40] must be considered as part of the computation of the assumed Federal income tax for the theoretical competitive products enterprise. Normally, depreciation would require a significant adjustment as the tax law generally allows a 200 percent declining balance, while the AMT rules only allow a 150 percent declining balance.[41] However, under 26 U.S.C. 55(e)(2)(A), only newly acquired assets will be subject to the AMT, and therefore, the AMT computations should be relatively simple. Further, if property is depreciated using the 26 U.S.C. 168(k) bonus depreciation (15-year life), no AMT adjustment is required for the depreciation component. The Postal Service should create a spreadsheet of the portion of assets allocated to the competitive products that were placed in service post September 30, 2007, and compute the difference between the regular tax and the AMT depreciation. However, no such AMT adjustment is required for real estate, intangibles, or leasehold improvements.

Capital and operating leases. The Postal Service should determine if its cost accounting systems have sufficient information available to distinguish capital leases from operating leases. In the case of operating leases, a deduction of rent expenses paid or accrued is allowed. In the case of capital leases, the lessor is the seller of the property on an installment basis. With regard to leases, the rules for tax purposes are

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[39] 26 U.S.C. 53-59.

[40] 26 U.S.C. 56(g).

[41] 26 U.S.C. 56(a)(1).

slightly different than the rules for financial statement purposes. Chapter 1 of the IRC utilizes the guidelines in Revenue Ruling 55-540 for determining if a lease is an operating or capital lease.

The Commission recommends that given the number of leases the Postal Service has outstanding and the time it would take to analyze all those lease agreements that only the portion of leases related to competitive products and entered into post September 30, 2007 should be subject to potential adjustment for tax purposes.

Health benefits. Health benefit costs are incurred by the Postal Service for both current employees and retirees. For purposes of the theoretical competitive products enterprise, the Federal Employees' Health Benefit Plan, which covers substantially all Postal Service employees, is the equivalent of a qualified funded Welfare Benefit Program. Therefore, the Postal Service's annual portion of the allocated costs related to the theoretical competitive products enterprise for fiscal year 2008 and later years are deductible. Similarly, the Postal Service's annual portion of the allocated retiree health benefit costs related to competitive products for fiscal year 2008 and later years are deductible. These costs are already reflected in the attributable costs so no adjustments to book income are necessary.

Pension plan costs. Postal Service employees participate in one of three government retirement programs depending on their date of hire.[42] The IRC contains a large number of complex rules and requirements for qualified pension plans. Among them are participation requirements, limits on annual benefits, and non-discrimination rules to prevent terms which favor highly compensated employees. There are also rules covering minimum funding standards and ceilings on deductions for contributions to the pension and annuity plans. In some areas, different rules apply to single employer plans and multi-employer plans. In general, the minimum funding

[42] The three retirement programs are the Civil Service Retirement System (CSRS), the Dual Civil Service Retirement System/Social Security (Dual CSRS), or the Federal Employees Retirement System (FERS). United States Postal Service Annual Report 2007, Note 10, at 49-51.

requirements must cover the liability for benefit accruals for the current year, as well as amortization of underfunded benefit accruals earned in prior years. The Commission concludes that the Postal Service's pension programs would qualify as the equivalent of qualified pension plans under 26 U.S.C. 401. Accordingly no adjustment to book income is required to determine taxable income.[43]

Workers' compensation costs. In Note 11 to its 2007 financial statements, the Postal Service states that it pays workers' compensation costs under a program administered by the Department of Labor.[44] This program is not a workers' compensation insurance program because the Postal Service pays the actual costs for postal workers injured on the job. The Postal Service estimates and records as a liability the estimated present value of the amount it expects to pay in the future for workers incurring job related injuries. Accordingly, the Postal Service self insures for workers' compensation and for accounting purposes accrues a liability and a related income statement expense.

For tax purposes, a deduction for self-insured workers' compensation is allowed in the year in which economic performance occurs. According to Treasury Regulation 1.461-4(g)(2), "[i]f the liability of a taxpayer requires a payment or series of payments to another person and arises under any workers compensation act …, economic performance occurs as payment is made to the person to which the liability is owed." The regulation contains an example in which a company enters into a workers' compensation insurance contract with an unrelated insurance company but must pay the first $5,000 of any damages. The company is deemed to be self-insured with respect to the $5,000, and economic performance occurs when the $5,000 is paid to the person to whom the workers' compensation liability is owed. *Id*. Example 7.

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[43] This area of Postal Service pension costs and plans should be revisited starting in 2017 when actuarial calculations required by section 802 of the PAEA could show an underfunded liability with respect to the Postal Service employees. Pub. L. 109-435, 120 stat. 3249, December 20, 2006.

[44] United States Postal Service Annual Report 2007 at 51-52.

In computing taxable income, workers compensation liabilities related to the theoretical competitive products enterprise arising in fiscal year 2008 and later are deductible when paid to the injured worker. The Postal Service also pays an administrative fee to the Office of Workers' Compensation Programs (OWCP) for processing workers' compensation claims. The fees for fiscal year 2008 and later years related to the theoretical competitive products enterprise should be deducted under normal accrual rules.

Available credits. The income tax law has various incentives that allow a dollar-for-dollar offset or credit against a taxpayer's tax liability. The purpose of many of these credits is to induce certain perceived economic or socially positive behaviors. The Commission believes that several of these credits may be available to the Postal Service to reduce the hypothetical tax liability of the theoretical competitive products enterprise under chapter 1 of the IRC. These credits include, but are not limited to, alternative fuel credit, targeted employee hiring credits, research and development credits, and rehabilitation credits. However, the Commission notes that applying any of the credits is elective. If the Postal Service finds that it would be too complex and cost prohibitive to compute any or all of the credits available relative to the competitive products activity, it may choose not to avail itself of these credits.

V. PERIODIC REPORTING REQUIREMENTS

Section 2011(h)(2)(B)(i)(III) provides for the submission by the Postal Service of annual and other periodic reports concerning competitive products setting forth such information as the Commission may require. In line with this provision, Treasury recommended that the Postal Service should "provide sufficient accounting and financial statements of operations reporting and supporting information for the theoretical USPS Competitive enterprise." Treasury Report at 29.

The Postal Service proposes to use an accounting and reporting methodology which it claims will satisfy the requirements set forth in the PAEA and follows closely the recommendations of the Department of Treasury. Using current GAAP-related accounting and costing systems, the Postal Service proposes, as indicated above, to produce three financial reports on competitive products financial activities: (1) an Annual Income Report; (2) an Annual Financial Status Report; and (3) an Annual Identified Property and Equipment Assets Report. The Postal Service's proposal involves the use of its current chart of accounts. *Id*. at 9-11.

As proposed by the Postal Service, the Annual Income Report would be derived from the data provided in the Annual Compliance Report. Using the results from the Cost and Revenue Analysis (CRA) report, the Annual Income Report would provide the total competitive product revenues less the competitive product attributable costs, competitive product group specific costs and the required competitive products' share of total institutional costs (currently set at 5.5 percent) at the end of each fiscal year. This computation would determine the total income of competitive products before payment of the assumed Federal income tax due on competitive products income.

The Commission accepts the Postal Service's proposed Annual Income Report as the basis of the assumed Federal income tax. The Commission has developed a format, which is incorporated into the proposed rules as Table 1. The data in the report should be traceable to the information supplied by the Postal Service that backs up the annual CRA report filed as part of the Annual Compliance Report. The Commission will also require that the Postal Service include as attachments to the income statement notes that show the source of the revenue and cost data used to produce the annual income statement and an explanation of the investments used to produce any investment income. The notes should also explain the calculation of the assumed Federal income tax and any special rules or accounting methods used to determine the tax.

The Postal Service's proposed competitive products enterprise Annual Financial Status Report would report the cumulative annual income for competitive products, the total financial obligations (outstanding debt) of competitive products, and the total financial investments of competitive products. This Annual Financial Status Report would show the balances at the beginning of the fiscal year, the annual changes from the prior year, and the ending values for the fiscal year for income, debt, and investments. The data underlying the Annual Financial Status Report would be derived from the Competitive Products Annual Income Report and the accounts reported in the system of accounts trial balance and the balance sheet of the audited financial statements. The Postal Service notes that it would identify the investments and obligations used solely by competitive products with a unique 3-digit sub-account number attached to the appropriate accounts in the General Ledger (Chart of Accounts). *Id*. at 14-16. The Postal Service would not attempt to allocate a portion of shared investments and obligations of the competitive products.

The Commission agrees with the Postal Service on the provision of the Annual Financial Status Report. The cumulative net income (loss) in the first line of the Financial Status Report is akin to the retained earnings column in the Statement of Changes in Net Capital as reported in the annual Consolidated Financial Statements. Additionally, a list of the obligations (type of obligation including interest rate) and investments would need to be included in this report.

The Public Representative remarks that the Annual Income Statement and the Annual Financial Status Report proposed by the Postal Service would rely on data inputs from the ACR. Public Representative Reply Comments at 3. It recommends that inputs should be allowed from the ACR as well as other sources the Commission deems to be appropriate. *Id*. It considers this advisable because the Postal Service voluntarily produced an ACR in 2008 prior to the Commission issuing final regulations as to what the Postal Service's specific annual reporting requirements should be. *Id*. The Commission recommends that all applicable data, including the ACR data and supporting documents, be used in compiling the required reports.

Lastly, the Postal Service proposes an Annual Identified Property and Equipment Assets Report that would list and value any property and equipment used specifically to provide competitive products. The Postal Service notes that currently there are no identifiable assets that can be specifically associated with competitive products. However, that does not preclude competitive product assets from being added in the future. The Postal Service proposes to use specific finance numbers (7-digit numbers associated with facilities or operational units) to identify assets used exclusively for competitive products. The Postal Service, however, only proposes assigning finance numbers if they decide to establish separate units for processing, transportation, delivery, or administrative functions for competitive products. Postal Service Comments at 17-18. Again, it does not propose to allocate a portion of shared assets to competitive products.

The Public Representative suggests that the Postal Service should be required to file an Annual Identified Property and Equipment Assets Report regardless of whether the Postal Service has identifiable assets that can be specifically associated with competitive products for any given year. Public Representative Comments at 4. It recommends that if no such assets can be reliably identified the report could be called "Statement in Lieu of Asset Report." *Id.* The Commission supports this suggestion.

Formats for the Financial Status Report and the Annual Identified Property and Equipment Asset Report as developed by the Commission are incorporated into the proposed rules as Tables 2 and 3.

The PAEA requires valuation of both assets and liabilities. In its initial comments, the Postal Service contends

> The annual income statement for Competitive Products will therefore be based on *an allocation of total accrued revenues and accrued expenses to the competitive products*, which, in turn, are based on economic and statistical analyses. Cash inflows from postage sales, meter settings, and trust account deposits cannot be identified by the product or service. Cash outflows for salaries and benefits, transportation, equipment, and other purchases pay for services and assets used by all products, and they cannot be identified by the product or service provided using the resource. There is no way, short of establishing a physically separate business entity with its own retail windows, labor force, and network, to create a balance sheet and track cash flows for competitive products.

Postal Service Comments at 8 (emphasis in original).

However, as discussed in detail above, it is possible to make a reasonable assignment of assets and liabilities to competitive products each year, and create a pro forma balance sheet, based on the same allocations of total accrued revenues and expenses used in the annual income statement. While the balance sheet will not be in strict compliance with generally accepted accounting principles, it will increase transparency and facilitate calculation of the assumed Federal income tax. The Commission believes that calculating and reporting just the assets allocable to competitive products will result in a distorted view of the strength of the competitive products enterprise.[45] The balance sheet can be constructed using ratios of revenues and attributable costs that are tied to the assets and liabilities. The format for the balance sheet will follow the current format for the consolidated Postal Service balance sheet and will be incorporated into the proposed rule.

[45] Moreover, beginning in FY 2010, Postal Service financial reports must include segment reporting, *i.e.*, a requirement that the Postal Service address the activities of its market dominant and competitive products business segments. *See* 39 U.S.C. 3654(b)(3)(A).

VI. SECTION-BY-SECTION ANALYSIS OF THE PROPOSED RULES

Below, the Commission provides a concise description of each rule designed to assist commenters in understanding the scope and nature of the proposed rules.

Rule 3060.1 Scope. This provision sets forth the scope of the Postal Service's obligation with regard to the assumed Federal income tax due on competitive products income. On an annual basis, the Postal Service must calculate the assumed Federal income tax on competitive products income and transfer any tax due from the Competitive Products Fund to the Postal Service Fund.

Rule 3060.10 Costing. This proposed rule defines income subject to tax as competitive products revenue minus competitive products costs. Competitive products costs are defined as volume-variable costs plus product-specific costs plus group specific costs plus assigned share of institutional costs. All costs are to be calculated using the methodologies most recently approved by the Commission.

Rule 3060.11 Valuation of Assets. This proposed rule sets forth the basis for assigning assets to the theoretical competitive products enterprise.

Rule 3060.12 Asset Allocation. This proposed rule requires the Postal Service to allocate all assets between competitive and market dominant products within 12 months of the effective date of the rule and to use these allocations to prepare the balance sheet required by rule 3060.30.

Rule 3060.13 Valuation of Liabilities. This proposed rule requires the Postal Service to allocate all liabilities between competitive and market dominant products within 12 months of the effective date of the rule and to use these allocations to prepare the balance sheet required by rule 3060.30.

Rule 3060.14 Competitive Products Balance Sheet. This proposed rule directs the Postal Service to prepare a competitive products balance sheet no later than FY 2010.

Rule 3060.20 Reports. This proposed rule sets forth the accounting procedures to be used for reporting on the theoretical competitive products enterprise. It sets the deadline for filing the reports at January 15; requires that each report include workpapers citing all numbers to primary sources and notes that provide summary descriptions of computations used, assumptions made, and other relevant information; specifies the books of accounts and data collection systems to be used; and requires the Postal Service to use the same accounting practices for future reports as approved by the Commission in its review of the January 15, 2009 reports unless changed by the Commission. The proposed rule also specifies the procedures which the Postal Service must use for any proposed changes in accounting practices.

Rule 3060.21 Income Report. This proposed rule requires the Postal Service to file an income report for the theoretical competitive products enterprise and specifies the form and content of the report.

Rule 3060.22 Financial Status Report. This proposed rule requires the Postal Service to file a report showing changes in net income, financial obligations, and financial investments for the theoretical competitive products enterprise and specifies the form and content of the report.

Rule 3060.23 Identified Property and Equipment Assets Report. This proposed rule requires the Postal Service to file a report showing net book value for assets devoted to the theoretical competitive products enterprise and specifies the form and content of the report.

Rule 3060.24 Competitive Products Fund Report. This proposed rule requires the Postal Service to file with the Commission a copy of the report filed with the Secretary of the Treasury pursuant to 39 U.S.C. 2011(i)(1).

Rule 3060.30 Pro Forma Balance Sheet. This proposed rule requires the Postal Service to file a report showing how total assets and liabilities of the Postal Service are allocated to the theoretical competitive products enterprise and specifies the form and content of the report.

Rule 3060.31 Initial Filing. This proposed rule sets the date for filing the first pro forma balance sheet at January 15, 2010, a year later than for other reports.

Rule 3060.40 Calculation of the Assumed Federal Income Tax. This proposed rule addresses how the assumed Federal income tax must be calculated and discusses the timing of such calculations. The proposed rule states that the assumed Federal income tax on competitive products income must be calculated in compliance with chapter 1 of the IRC. A calculation under chapter 1 of the IRC requires the computation of the competitive products' assumed tax liability at either the section 11 (regular) or section 55(b)(1)(B) (AMT) tax rates, as applicable. The provision further provides that no estimated taxes need to be calculated or paid and also states that no state, local, or foreign taxes need to be calculated or paid.

With regard to the timing of the calculation of the assumed Federal income tax, the proposed rule provides that the end of the fiscal year for the calculation of the tax shall be September 30 (which coincides with the Postal Service's regular fiscal year end). The provision further requires that the assumed Federal income tax must be calculated by January 15 of the following year.

Rule 3060.41 Supporting Documentation. This proposed rule specifies the underlying details that the Postal Service must provide to support its calculation of tax liability under rule 3060.40.

Rule 3060.42 Commission Review. This proposed rule states that the Commission will review the documentation submitted under rule 3060.41 and issue an order on its findings by July 15. The proposed rule also states that the Commission may order the Postal Service to cure or explain any errors, omissions, or other deficiencies discovered within 3 years of a filing pursuant to rule 3060.40.

Rule 3060.43 One-Time Extension. The proposed rule allows for a one-time extension of 6 months, until July 15, 2009, for the calculation of the assumed Federal income tax due for fiscal year end September 30, 2008.

Rule 3060.44 Annual Transfer from Competitive Products Fund to the Postal Service Fund. This proposed rule provides a "payment" method for the assumed Federal income tax due on competitive products' income. On an annual basis, the Postal Service must transfer the assumed Federal income tax due on competitive products income from the Competitive Products Fund to the Postal Service Fund. As long as a tax is actually due, it must be transferred to the Postal Service Fund no later than January 15 of the year following the close of the fiscal year. As with the calculation in proposed rules 3060.40 and 3060.43, a one-time 6-month extension, until July 15, 2009, is granted for the transfer of the assumed Federal income tax due for fiscal year end September 30, 2008.

Under this proposed rule, if competitive products' assumed taxable income for a given fiscal year is negative, the Postal Service is not required to pay a tax for that year, but may be entitled to claim a loss. If a payment was made to the Postal Service Fund in the previous year, the Postal Service may transfer the lesser of (1) the amount paid into the Postal Service Fund in the past 2 years, or (2) the amount of the loss to the Postal Service Fund. This transfer must also be made no later than January 15 of the year following the end of the fiscal year. If, however, no payment was made into the Postal Service Fund in the previous 2 years, the loss may only be carried forward and offset against any calculated assumed Federal income tax on competitive products income for the following 20 years.

VII. PROPOSED RULES

PART 3060—ACCOUNTING PRACTICES AND TAX RULES FOR THE THEORETICAL COMPETITIVE PRODUCTS ENTERPRISE

§ 3060.1 Scope

The rules in this part are applicable to the Postal Service's theoretical competitive products enterprise developed pursuant to 39 U.S.C. 2011 and 3634 and to the Postal Service's obligation to calculate annually an assumed Federal income tax on competitive products income and transfer annually any such assumed Federal income tax due from the Competitive Products Fund to the Postal Service Fund.

§ 3060.10 Costing

(a) The assumed taxable income from competitive products for the Postal Service's theoretical competitive products enterprise for a fiscal year shall be based on total revenues generated by competitive products during that year less the costs identified in paragraph (b) calculated using the methodology most recently approved by the Commission.

(b) The net income for the Postal Service's theoretical competitive products enterprise shall reflect the following costs:

(1) Attributable costs, including volume variable and product specific costs;

(2) Group specific costs defined as those costs incurred in the provision of competitive products as a whole which cannot be causally related to any specific competitive product; and

(3) The appropriate share of institutional costs assigned to competitive products by the Commission pursuant to 39 U.S.C. 3633(a)(3).

§ 3060.11 Valuation of Assets

For the purposes of 39 U.S.C. 2011, the total assets of the Postal Service theoretical competitive products enterprise are the greater of:

(a) The percentage of total Postal Service revenues and receipts from competitive products times the total net assets of the Postal Service, or

(b) The net assets related to the provision of competitive products as determined pursuant to rule 3060.12.

§ 3060.12 Asset Allocation

Within 6 months of the effective date of these rules, and for each fiscal year thereafter, the Postal Service will develop the net assets of the theoretical competitive products enterprise as follows:

(a) Identify all asset accounts within the Postal Service's Chart of Accounts used solely for the provision of competitive products.

(b) Identify all asset accounts within the Postal Service's Chart of Accounts used solely for the provision of market dominant products.

(c) The portion of asset accounts in the Postal Service's Chart of Accounts that are not identified in either (a) or (b) above shall be assigned to the Postal Service theoretical competitive products enterprise using a method of allocation based on appropriate revenue or cost drivers approved by the Commission.

(d) Within 6 months of the effective date of these rules the Postal Service shall submit to the Commission for approval a proposed methodology detailing how each asset account identified in the Chart of Accounts shall be allocated to the theoretical competitive products enterprise and provide an explanation in support of each allocation.

(e) If the Postal Service desires to change the methodologies outlined above, it shall utilize the procedures provided in rule 3050.11.

§ 3060.13 Valuation of Liabilities

Within 6 months of the effective date of these rules, and for each fiscal year thereafter, the Postal Service will develop the liabilities of the theoretical competitive products enterprise as follows:

(a) Identify all liability accounts within the Postal Service's Chart of Accounts used solely for the provision of competitive products.

(b) Identify all liability accounts within the Postal Service's Chart of Accounts used solely for the provision of market dominant products.

(c) The portion of liability accounts in the Postal Service's Chart of Accounts that are not identified in either (a) or (b) above shall be assigned to the theoretical competitive products enterprise using a method of allocation based on appropriate revenue or cost drivers approved by the Commission.

(d) Within 6 months of the effective date of these rules the Postal Service shall submit to the Commission for approval a proposed methodology detailing how each liability account identified in the Chart of Accounts shall be allocated to the theoretical competitive products enterprise and provide an explanation in support of each allocation.

(e) If the Postal Service desires to change the methodologies outlined above, it shall utilize the procedures provided in rule 3050.11.

§ 3060.14 Competitive Products Enterprise Balance Sheet

(a) The Postal Service will report the assets and liabilities of the theoretical competitive products enterprise as computed under rules 3060.12 and 3060.13 in the format as proscribed under rule 3060.30 for each fiscal year starting with FY 2010.

§ 3060.20 Reports

(a) The Postal Service shall file with the Commission each of the reports required by this part by no later than January 15 of each year.

(b) Each report shall include workpapers that cite all numbers to primary sources and such other information needed to present complete and accurate financial information concerning the provision of competitive products.

(c) Each report shall utilize the same books of accounts and data collection systems used to produce the report required by 39 CFR 3050.

(d) Each report shall include summary descriptions of computations used, assumptions made, and other relevant information in the form of notes to the financial statements.

(e) The accounting practices used by the Postal Service in the reports filed January 15, 2009, as approved by the Commission, shall be used for all future reports until such time as they may be changed by the Commission. If the Postal Service desires to change such practices, it shall utilize the procedures provided in rule 3050.11.

§ 3060.21 Income Report

The Postal Service shall file an Income Report in the form and content of Table 1, below.

Table 1
Proposed Competitive Products Income Statement
($ in 000s)

	FY20xx	**FY 20xx-1**	**% Change from SPLY**	**% Change from SPLY**
Revenue:	$x,xxx	$x,xxx	$xxx	xx.x%
(1) Mail and Services Revenues	xxx	xxx	xx	xx.x%
(2) Investment Income	$x,xxx	$x,xxx	$xxx	xx.x%
(3) Total Competitive Products Revenue				
Expenses:				
(4) Volume-Variable Costs	$x,xxx	$x,xxx	$xxx	xx.x%
(5) Product Specific Costs	x,xxx	x,xxx	xxx	xx.x%
(6) Group Specific Costs	x,xxx	x,xxx	xxx	xx.x%
(7) Total Competitive Products Attributable Costs	$x,xxx	$x,xxx	$xxx	xx.x%
(8) Net Income Before Institutional Cost Contribution	$x,xxx	$x,xxx	$xxx	
(9) Required Institutional Cost Contribution (5.5%)	$x,xxx	$x,xxx	$xxx	x.x%
(10) Net Income (Loss) Before Tax	$x,xxx	$x,xxx	$xxx	
(11) Assumed Federal Income Tax	$x,xxx	$x,xxx	$xxx	xx.x%
(12) Net Income (Loss) After Tax	$x,xxx	$x,xxx	$xxx	xx.x%
Line (1): Total revenues from competitive products volumes and Ancillary Services				
Line (2): Income provided from investment of surplus competitive products revenues				
Line (3): sum total of revenues from competitive products volumes, services, and investments				
Line (4): Total competitive products volume variable costs as shown in the Cost and Revenue Analysis (CRA) report				
Line (5): Total competitive products volume variable costs as shown in the CRA report				
Line (6): total competitive products specific fixed costs not attributable to a specific competitive product				
Line (7): Sum total of competitive products costs (sum of lines 4-6)				
Line (8): Difference between competitive products total revenues and attributable costs (line 3 less line 7)				
Line (9): Minimum amount of Institutional Cost contribution required under 39 CFR 3015.7.				
Line (10): Line 8 less line 9				
Line (11): Total assumed Federal income tax as calculated under 39 CFR 3060.40				
Line (12): Line 10 less line 11				

§ 3060.22 Financial Status Report

The Postal Service shall file a Financial Status Report in the form and content of Table 2, below.

Table 2: Annual Summary of Competitive Products Financials **PRC Form CP-02**
($ in 000s)

		Beginning Value	Change from Prior Year	Ending Value
(1)	Cumulative Net Income (Loss) after Assumed Federal Income Tax			
(2)	Total Financial Obligations (List of financial obligations)			
(3)	Total Financial Investments (List of financial investments			

Line 1: **Beginning Value:** Sum total of Net Income (Loss) as of October 1 of Reportable Fiscal Year
Change from Prior Year: Amount of Net Income (Loss) of reportable Fiscal Year
Ending Value: Sum of Beginning Value and the Change from Prior Year

Line 2: **Beginning Value:** Sum total of Financial Obligations as of October 1 of Reportable Fiscal Year
Change from Prior Year: Amount of Net Financial Obligations of reportable Fiscal Year
Ending Value: Sum of Beginning Value and the Change from Prior Year

Line 3: **Beginning Value:** Sum total of Financial Investments as of October 1 of Reportable Fiscal Year
Change from Prior Year: Amount of Net Financial Investments of reportable Fiscal Year
Ending Value: Sum of Beginning Value and the Change from Prior Year

§ 3060.23 Identified Property and Equipment Assets Report

The Postal Service shall file an Identified Property and Equipment Assets Report in the form and content of Table 3, below.

Table 3: Competitive Products Property and Equipment Assets **PRC Form CP-03**
($ in 000s)

Finance Number	Finance Location	Asset Identifier	Asset Description	Cost	Accumulated Depreciation	Net Book Value
Total				$x,xxx	$x,xxx	$x,xxx

§ 3060.24 Competitive Products Fund Report

Within 90 days of the close of each fiscal year the Postal Service will provide the most recent report of the activity of the Competitive Products Fund as provided to the Secretary of the Treasury under 39 U.S.C. 2011(i)(1).

§ 3060. 30 Pro Forma Balance Sheet

(a) The Postal Service shall file a Pro Forma Balance Sheet in the form and content of Table 4, below.

Table 4: Competitive Products Pro Forma Balance Sheet **PRC Form CP-04**
($ in Millions)

Total Net Assets	**FY 20XX** USPS Annual Report	**FY 20XX** Competitive Products	**FY 20XX-1** Competitive Products	**Distributed on Basis of:**
Cash and Cash Equivalents	$x,xxx	$x,xxx	$x,xxx	
Net Accounts Receivables	x,xxx	x,xxx	x,xxx	
Supplies, Advances, and Prepayments	x,xxx			
Appropriations Receivable - Revenue Foregone	x,xxx			
Total Current Assets	x,xxx	x,xxx	x,xxx	
Property and Equipment:				
Buildings	x,xxx	x,xxx	x,xxx	
Leasehold Improvements	x,xxx	x,xxx	x,xxx	
Equipment	x,xxx	x,xxx	x,xxx	
Land	x,xxx	x,xxx	x,xxx	
	x,xxx	x,xxx	x,xxx	
Accumulated Depreciation	x,xxx	x,xxx	x,xxx	
	x,xxx	x,xxx	x,xxx	
Construction in Progress	x,xxx	x,xxx	x,xxx	
Total Property and Equipment, Net	x,xxx	x,xxx	x,xxx	
Total Assets	$x,xxx	$x,xxx	$x,xxx	
Total Assets determined from Sec. 2011(e)(5)	$x,xxx	$x,xxx	$x,xxx	

Total Net Liabilities	**FY 20XX** USPS Annual Report	**FY 20XX** Competitive Products	**FY 20XX-1** Competitive Products	
Liabilities:				**Distributed on Basis of:**
Current Liabilities:				
Compensation and Benefits	$x,xxx	$x,xxx	$x,xxx	
Payables and Accrued Expenses	x,xxx			
Customer Deposit Accounts	x,xxx	x,xxx	x,xxx	
Deferred Revenue-Prepaid Postage	x,xxx	x,xxx	x,xxx	
Outstanding Postal Money Orders	x,xxx			
Prepaid box rent and other deferred revenue	x,xxx			
Debt	x,xxx	x,xxx	x,xxx	
Non-Current Liabilities:				
Workers' Compensation	x,xxx	x,xxx	x,xxx	
Employees Accumulated Leave	x,xxx	x,xxx	x,xxx	
Deferred Appropriation and Other Revenue	x,xxx			
Long-Term Portion Capital Lease Obligations	x,xxx	x,xxx	x,xxx	
Deferred Gains on Sales of Property	x,xxx	x,xxx	x,xxx	
Contingent Liabilities and Other	x,xxx			
Total Liabilities	$x,xxx	$x,xxx	$x,xxx	

(b) The Pro Forma Balance Sheet shall detail the analysis and selection of methods of allocation of total assets and liabilities to the competitive products.

§ 3060.31 Initial Filing

The due date for filing the initial Pro Forma Balance Sheet is January 15, 2010.

§ 3060.40 Calculation of the Assumed Federal Income Tax

(a) The assumed Federal income tax on competitive products income shall be based on the Postal Service theoretical competitive products enterprise income statement for the relevant year and must be calculated in compliance with chapter 1 of the Internal Revenue Code by computing the tax liability on the taxable income from the competitive products of the Postal Service theoretical competitive products enterprise at the section 11 (regular) or section 55(b)(1)(B) (Alternative Minimum Tax) tax rates, as applicable.

(b) The end of the fiscal year for the annual calculation of the assumed Federal income tax on competitive products income shall be September 30.

(c) The calculation of the assumed Federal income tax due shall be submitted to the Commission no later than January 15 next occurring following the close of the fiscal year referenced in paragraph (b), except that a one-time extension of 6 months, until July 15, 2009, shall be permitted for the calculation of the assumed Federal income tax due for fiscal year end September 30, 2008.

(d) No estimated taxes need to be calculated or paid.

(e) No state, local, or foreign taxes need to be calculated.

§ 3060.41 Supporting Documentation

(a) In support of its calculation of the assumed Federal income tax, the Postal Service shall file detailed schedules reporting the Postal Service theoretical competitive products enterprise assumed taxable income, effective tax rate, and tax due.

(b) Adjustments made to book income, if any, to arrive at the assumed taxable income for any year shall be submitted to the Commission no later than January 15 of the following year.

§ 3060.42 Commission Review

(a) The Commission will review the supporting documentation submitted by the Postal Service pursuant to rule 3060.41 and issue an order either approving the calculation of the assumed Federal income tax for that tax year or taking such other action as the Commission deems appropriate, including, but not limited to, directing the Postal Service to file additional supporting materials.

(b) The Commission will issue such order no later than 6 months after the Postal Service's filing pursuant to rule 3060.40.

(c) Notwithstanding paragraph (b), if the Commission determines within 3 years of its submission that the Postal Service's calculation of an assumed Federal income tax is incomplete, inaccurate, or otherwise deficient, the Commission will notify the Postal Service in writing and provide it with an opportunity to cure or otherwise explain the deficiency. Upon receipt of the Postal Service's responsive pleading, the Commission may order such action as it deems appropriate.

§ 3060.43 Annual Transfer from Competitive Products Fund to Postal Service Fund

(a) The Postal Service must on an annual basis transfer the assumed Federal income tax due on competitive products income from the Competitive Products Fund to the Postal Service Fund.

(b) If the assumed taxable income from competitive products for a given fiscal year is positive, the assumed Federal income tax due, calculated pursuant to rule 3060.40, shall be transferred to the Postal Service Fund no later than January 15 next occurring following the close of the relevant fiscal year.

(c) A one-time extension of 6 months, until July 15, 2009, shall be permitted for the transfer of the assumed Federal income tax due for fiscal year ending September 30, 2008.

(d) If assumed taxable income from competitive products for a given fiscal year is negative:

(1) If a payment was made to the Postal Service Fund for the previous tax year, a transfer equaling the lesser of the amount paid into the Postal Service Fund for the past 2 tax years or the amount of the loss shall be made from the Postal Service Fund to the Competitive Products Fund no later than January 15 next occurring following the close of the relevant fiscal year; or

(2) If no payment has been made into the Postal Service Fund for the previous 2 tax years, the loss may be carried forward and offset against any calculated assumed Federal income tax on competitive products income for 20 years.

It is Ordered:

1. Docket No. RM2008-5 is established for the purpose of receiving comments on the Commission's proposed rules under the Postal Accountability and Enhancement Act regarding the accounting practices and principles to be followed by the Postal Service as well as the substantive and procedural rules for determining the assumed Federal income tax on competitive products income.

2. Interested persons may submit initial comments no later than 30 days from the date of publication of this Notice in the *Federal Register*.

3. Reply comments may be filed no later than 45 days from the date of publication of this Notice in the *Federal Register*.

4. Patricia A. Gallagher is designated as the Public Representative representing the interests of the general public in this proceeding.

5. The Secretary shall arrange for publication of this Notice in the *Federal Register*.

By the Commission.

Steven W. Williams
Secretary