

by a taxpayer with respect to public utility property for purposes of determining cost of service for ratemaking purposes or rate base for ratemaking purposes shall not be considered in determining whether the taxpayer used a flow-through method of regulated accounting. A taxpayer may establish use of a flow-through method of regulated accounting in the same manner that compliance with normalization requirements in respect of operating books of account may be established under paragraph (h)(4) of this section.

[T.D. 7315, 39 FR 20195, June 7, 1974]

§ 1.167(l)-2 Public utility property; election as to post-1969 property representing growth in capacity.

(a) *In general.* Section 167(l)(2) prescribes the methods of depreciation which may be used by a taxpayer with respect to its post-1969 public utility property. Under section 167(l)(2) (A) and (B) the taxpayer may use a subsection (l) method of depreciation (as defined in section 167(l)(3)(F)) or any other method of depreciation which is otherwise allowable under section 167 if, in conjunction with the use of such other method, such taxpayer uses the normalization method of accounting (as defined in section 167(l)(3)(G)). Paragraph (2)(C) of section 167(l) permits a taxpayer which used the flow-through method of accounting for its July 1969 accounting period (as these terms are defined in section 167(l)(3) (H) and (I), respectively) to use its applicable 1968 method of depreciation with respect to certain property. Section 167(l)(3)(D) describes the term "applicable 1968 method". Accordingly, a regulatory agency is not precluded by section 167(l) from requiring such a taxpayer subject to its jurisdiction to continue to use the flow-through method of accounting unless the taxpayer makes the election pursuant to section 167(l)(4)(A) and this section. Whether or not the election is made, if such a regulatory agency permits the taxpayer to change from the flow-through method of accounting, subsection (l)(2) (A) or (B) would apply and such taxpayer could, subject to the provisions of section 167(e) and the regulations thereunder (relating to change in method), use a subsection (l) method of depreciation

or, if the taxpayer uses the normalization method of accounting, any other method of depreciation otherwise allowable under section 167.

(1) *Election.* Under subparagraph (A) of section 167(l)(4), if the taxpayer so elects, the provisions of paragraph (2)(C) of section 167(l) shall not apply to its qualified public utility property (as such term is described in paragraph (b) of this section). In such case the taxpayer making the election shall use a method of depreciation prescribed by section 167(l)(2) (A) or (B) with respect to such property.

(2) *Property to which election shall apply.* (i) Except as provided in subdivision (ii) of this subparagraph the election provided by section 167(l)(4)(A) shall apply to all of the qualified public utility property of the taxpayer.

(ii) In the event that the taxpayer wishes the election provided by section 167(l)(4)(A) to apply to only a portion of its qualified public utility property, it must clearly identify the property to be subject to the election in the statement of election described in paragraph (e) of this section. Where all property which performs a certain function is included within the election, the election shall apply to all future acquisitions of qualified public utility property which perform the same function. Where only certain property within a functional group of property is included within the election, the election shall apply only to property which is of the same kind as the included property.

(iii) The provisions of subdivision (ii) of this subparagraph may be illustrated by the following examples:

Example (1). Corporation A, an electric utility company, wishes to have the election provided by section 167(l)(4)(A) apply only with respect to its production plant. A statement that the election shall apply only with respect to production plant will be sufficient to include within the election all of the taxpayer's qualified production plant of any kind. All public utility property of the taxpayer other than production plant will not be subject to the election.

Example (2). Corporation B, an electric utility company, wishes to have the election provided by section 167(l)(4)(A) apply only with respect to nuclear production plant. A statement which clearly indicates that only nuclear production plant will be included in the election will be sufficient to exclude

from the election all public utility property other than nuclear production plant.

(b) *Qualified public utility property*—(1) *Definition.* For purposes of this section the term “qualified public utility property” means post-1969 public utility property to which section 167(l)(2)(C) applies, or would apply if the election described in section 167(l)(4)(A) had not been made, to the extent that such property constitutes property which increases the productive or operational capacity of the taxpayer with respect to the goods or services described in section 167(l)(3)(A) and does not represent the replacement of existing capacity. In the event that particular assets which are post-1969 public utility property both replace existing public utility property and increase the productive or operational capacity of the taxpayer, only that portion of each such asset which is properly allocable, pursuant to the provisions of subparagraph (3)(v) of this paragraph or paragraph (c)(2) of this section (as the case may be), to increasing the productive or operational capacity of the taxpayer shall be qualified public utility property.

(2) *Limitation on use of formula method.* A taxpayer which makes the election with respect to all of its post-1969 public utility property may determine the amount of its qualified public utility property by using the formula method described in paragraph (c) of this section or, where the taxpayer so chooses, it may use any other method based on engineering data which is satisfactory to the Commissioner. A taxpayer which chooses to include only a portion of its post-1969 public utility property in the election described in paragraph (a)(1) of this section shall, in a manner satisfactory to the Commissioner and consistent with the provisions of subparagraph (3) of this paragraph, use a method based on engineering data. If a taxpayer uses the formula method described in paragraph (c) of this section, it must continue to use such method with respect to additions made in subsequent taxable years. The taxpayer may change from an engineering method to the formula method

described in paragraph (c) of this section by filing a statement described in paragraph (h) of this section if it could have used such formula method for the prior taxable year.

(3) *Measuring capacity under an engineering method in the case of a general election.* (i) The provisions of this subparagraph apply in the case of an election made with respect to all of the post-1969 public utility property of the taxpayer.

(ii) A taxpayer which uses a method based on engineering data to determine the portion of its additions for a taxable year which constitutes qualified public utility property shall make such determination with reference to its “adjusted capacity” as of the first day of the taxable year during which such additions are placed in service. For purposes of this subparagraph, the term “adjusted capacity” means the taxpayer’s capacity as of January 1, 1970, adjusted upward in the manner described in subdivision (iii) of this subparagraph for each taxable year ending after December 31, 1969, and before the first day of the taxable year during which the additions described in the preceding sentence are placed in service.

(iii) The adjustment described in this subdivision for each taxable year shall be equal to the number of units of capacity by which additions for the taxable year of public utility property with respect to which the election had been made exceed the number of units of capacity of retirements for such taxable year of public utility property with respect to which the flow-through method of accounting was being used at the time of their retirement. If for any taxable year the computation in the preceding sentence results in a negative amount, such negative amount shall be taken into account as a reduction in the amount of the adjustment (computed without regard to this sentence) in succeeding taxable years.

(iv) The provisions of this subparagraph may be illustrated by the following table which assumes that the taxpayer’s adjusted capacity as of January 1, 1970, was 5,000 units:

1	2	3	4	5	6	7
Year	Additions	Flow-through retirements	Net additions	Adjusted capacity ¹	Actual capacity	Units of qualified additions ^{1 2}
1970	1000	700	300	5000	5300	300
1971	300	500	(200)	5300	5100
1972	500	200	300	5300	5400	100
1973	400	800	(400)	5400	5000
1974	600	400	200	5400	5200
1975	800	300	500	5400	5700	300

¹ Capacity as of Jan. 1, 1970, plus amounts in column 7 for years prior to the year for which determination is being made.
² Column 6 minus column 5.

(v) The qualified portion of the basis for depreciation (as defined in section 167(g)) of each asset or group of assets (if group or composite accounting is used by the taxpayer) subject to the election shall be determined using the following ratio:

$$\frac{\text{Qualified portion of basis of asset} + \text{Total basis of asset}}{\text{Units of qualified additions computed in column 7 on chart} + \text{Units of capacity of additions computed in column 2 on chart}} = \text{Ratio}$$

(c) *Formula method of determining amount of property subject to election—(1) In general.* The following formula method may be used to determine the amount of qualified public utility property:

Step 1. Find the total cost (within the meaning of section 1012) to the taxpayer of additions during the taxable year of all post-1969 public utility property with respect to which section 167(l)(2)(C) would apply if the election had not been made.

Step 2. Aggregate the cost (within the meaning of section 1012) to the taxpayer of all retirements during the taxable year of public utility property with respect to which the flow-through method of accounting was being used at the time of their retirement.

Step 3. Subtract the figure reached in step 2 from the figure reached in step 1.

In the event that the figure reached in step 2 exceeds the figure reached in step 1 such excess shall be carried forward to the next taxable year and shall be aggregated with the cost (within the meaning of section 1012) to the taxpayer of all retirements referred to in step 2 for such next taxable year.

(2) *Allocation of bases.* The amount of qualified public utility property as determined in accordance with the formula method described in subparagraph (1) of this paragraph shall be allocated to the basis for depreciation (as

defined in section 167(g)) of each asset or group of assets (if group or composite accounting is used by the taxpayer) subject to the election using the following ratio:

$$\frac{\text{Amount of qualified additions computed in step 3} + \text{Amount of total additions computed in step 1}}{\text{Qualified portion of basis of asset} + \text{Total basis of asset}} = \text{Ratio}$$

(d) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). Corporation A, a telephone company subject to the jurisdiction of the Federal Communications Commission, elected, pursuant to the provisions of section 167(l)(4)(A) and this section, with respect to all of its qualified post-1969 public utility property to have the provisions of paragraph (2) (C) of section 167(l) not apply. In 1971 the Corporation added new underground cable with a cost (within the meaning of section 1012) to it of \$4 million to its underground cable account. In the same year it retired public utility property with a cost (within the meaning of section 1012) to Corporation A of \$1.5 million. The flow-through method of accounting was being used with respect to all of the retired property at the time of retirement. Using the formula method described in paragraph (c) of this section, the amount of qualified underground cable would be determined as follows:

	Million
<i>Step 1.</i> Aggregate cost of flow-through additions ...	\$4.0
<i>Step 2.</i> Cost of all flow-through retirements	1.5

<i>Step 3.</i> Figure reached in step 1 less figure reached in step 2	2.5

The amount of qualified public utility property to which section 167(l)(2)(C) will not apply is \$2.5 million. Pursuant to the provisions of paragraph (c)(2) of this section, the amount of qualified public utility property would be allocated to the basis for depreciation (as defined in section 167(g)) of an asset with a total basis for depreciation of \$2 million as follows:

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\$2.5 million (figure in step 3)/\$4 million (figure in step 1) = Qualified portion of basis of asset/\$2 million Qualified portion of basis of asset = \$1.25 million.

Example (2). In 1972 Corporation A (the corporation described in example (1)) added underground cable with a cost (within the meaning of section 1012) to it of \$1 million. In the same year the cost (within the meaning of section 1012) to the corporation of retirements of public utility property with respect to which the flow-through method of accounting was being used was \$3 million. There were no other additions or retirements. The amount of qualified public utility property would be determined as follows:

	Million
Step 1. Aggregate cost of flow-through additions	\$1.0
Step 2. Cost of all flow-through retirements	3.0
Step 3. Figure reached in step 1 less figure reached in step 2	(2.0)

Since retirements of flow-through public utility property for the year 1972 exceeded additions made during such year, the excess retirements, \$2.0 million, must be carried forward to be aggregated with retirements for 1973.

Example (3). Corporation B, a gas pipeline company subject to the jurisdiction of the Federal Power Commission, made the election provided by section 167(l)(4)(A) and this section with respect to all of its post-1969 public utility property. Corporation B chose to use an engineering data method of determining which property was subject to the election provided by this section. In 1970, the corporation replaced a portion of its pipeline with respect to which the flow-through method of accounting was being used at the time of its retirement which had a peak capacity on January 1, 1970, of 100,000 thousand cubic feet (M c.f.) per day at a pressure of 14.73 pounds per square inch absolute (p.s.i.a.) with pipe with a capacity of 125,000 M c.f. per day at 14.73 p.s.i.a. Assuming that there were no other additions or retirements, using an engineering data method one-fifth of the new pipeline would be property subject to the election of this section effective for its taxable year beginning on January 1, 1971.

Example (4). In 1970 Corporation C (with the same characteristics as the corporation described in example (3)) extended its pipeline 5 miles further than it extended on January 1, 1970. Assuming that there were no other additions or retirements, the entire extension would be property subject to the election provided by this section effective for its taxable year beginning on January 1, 1971.

Example (5). As a result of a change of service areas between two corporations, in 1970 Corporation D (with the same characteristics as the corporation described in example (3)) retired a pipeline running north and south

and replaced it with a pipeline of equal length and capacity running east and west. No part of the pipeline running east and west is property subject to the election.

(e) *Manner of making election.* The election described in paragraph (a) of this section shall be made by filing, in duplicate, with the Commissioner of Internal Revenue, Washington, D.C. 20224, Attention, T:I:E, a statement of such election.

(f) *Content of statement.* The statement described in paragraph (e) of this section shall indicate that an election is being made under section 167(l) of the Internal Revenue Code of 1954, and it shall contain the following information:

(1) The name, address, and taxpayer identification number of the taxpayer,

(2) Whether the taxpayer will use the formula method of determining the amount of its qualified public utility property described in paragraph (c) of this section, or an engineering method, and

(3) Where the taxpayer wishes to include only a portion of its public utility property in the election pursuant to the provisions of paragraph (a)(2) of this section, a description sufficient to clearly identify the property to be included.

(g) *Time for making election.* The election permitted by this section shall be made by filing the statement described in paragraph (e) of this section not later than Monday, June 29, 1970.

(h) *Change of method of determining amount of qualified property.* Where a taxpayer which has elected pursuant to the provisions of section 167(l)(4)(A) wishes to change, pursuant to the provisions of paragraph (b)(2) of this section, from an engineering data method of determining which of its property is qualified public utility property to the formula method described in paragraph (c) of this section, it may do so by filing a statement to that effect at the time that it files its income tax return, with the district director or director of the regional service center, with whom the taxpayer's income tax return is required to be filed.

(i) *Revocability of election.* An election made under section 167(l) shall be irrevocable.

(j) *Effective date.* The election prescribed by section 167(l)(4)(A) and this section shall be effective for taxable years beginning after December 31, 1970.

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§ 1.167(l)-3 Multiple regulation, asset acquisitions, reorganizations, etc.

(a) *Property not entirely subject to jurisdiction of one regulatory body—(1) In general.* If a taxpayer which uses a method of depreciation other than a subsection (l) method of depreciation is required by a regulatory body having jurisdiction over less than all of its property to use, or not to use, a method of regulated accounting (i.e., normalization or flow-through), such taxpayer shall be considered as using, or not using, such method of regulated accounting only with respect to property subject to the jurisdiction of such regulatory body. In the case of property which is contained in a multiple asset account, the provisions of § 1.167(a)-7(c) and § 1.167 (a)-11(c)(1)(iv) apply to prohibit depreciating a single account by two or more different methods.

(2) *Jurisdiction of regulatory body.* For purposes of this paragraph, a regulatory body is considered to have jurisdiction over property of a taxpayer if expenses with respect to the property are included in cost of service as determined by the regulatory body for ratemaking purposes or for reflecting operating results in its regulated books of account. For example, if regulatory body A, having jurisdiction over 60 percent of an item of X corporation's public utility property, required X to use the flow-through method of regulated accounting in circumstances which would bar X from using a method of depreciation under section 167(a) other than a subsection (l) method, and if regulatory body B, having jurisdiction over the remaining 40 percent of such item of property does not so require X to use the flow-through method of regulated accounting (or if the remaining 40 percent is not subject to the jurisdiction of any regulatory body), then with respect to 60 percent of the adjusted basis of the property X is prohibited from using a method of depreciation for purposes of section 167(a) other

than a subsection (l) method. If in such example, A, having jurisdiction over 60 percent of X's public utility property, had jurisdiction over 100 percent of a particular generator, then with respect to the generator X would be prohibited from using a method of depreciation other than a subsection (l) method.

(3) *Public utility property subject to more than one regulatory body.* If a regulatory body having jurisdiction over public utility property with respect to the taxpayer's regulated books of account requires the taxpayer to reflect its tax expense in such books in the manner used by the regulatory body having jurisdiction over the public utility property for purposes of determining the taxpayer's cost of service for ratemaking purposes, the rules of subparagraphs (1) and (2) of this paragraph shall apply.

(b) *Leasing transactions—(1) Leased property.* Public utility property as defined in paragraph (b) of § 1.167(l)-1 includes property which is leased by a taxpayer where the leasing of such property is part of the lessor's section 167(l) public utility activity. Thus, such leased property qualifies as public utility property even though the predominant use of such property by the lessee is in other than a section 167(l) public utility activity. Further, leased property qualifies as public utility property under section 167(l) even though the leasing is not part of the lessor's public utility activity if the predominant use of such property by the lessee or any sublessee is in a section 167(l) public utility activity. However, the limitations of section 167(l) apply to a taxpayer only if such taxpayer is subject to the jurisdiction of a regulatory body described in a section 167(l)(3)(A). For example, if a financial institution purchases property which it then leases to a lessee which uses such property predominantly in a section 167(l) public utility activity, the property qualifies as public utility property. However, because the financial institution's rates for leasing the property are not subject to the jurisdiction of a regulatory body described in section 167(l)(3)(A), the provisions of section 167(l) do not apply to the depreciation deductions taken with respect to