Joint committee explanation.

Senate Amendment

The Senate amendment follows the House bill, but does not provide a special rate for personal service corporations.

Effective date.–The provision applies to taxable years beginning after December 31, 2018.

Conference Agreement

The conference agreement follows the Senate amendment, but provides for a 21-percent corporate rate effective for taxable years beginning after December 31, 2017.

In addition, for taxpayers subject to the normalization method of accounting (*e.g.*, regulated public utilities), the conference agreement clarifies the normalization of excess tax reserves resulting from the reduction of corporate income tax rates (with respect to prior depreciation or recovery allowances taken on assets placed in service before the corporate rate reduction takes effect).

The excess tax reserve is the reserve for deferred taxes as of the day before the corporate rate reduction takes effect over what the reserve for deferred taxes would be if the corporate rate reduction had been in effect for all prior periods. If an excess tax reserve is reduced more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method, the taxpayer will not be treated as using a normalization method with respect to the corporate rate reduction. If the taxpayer does not use a normalization method of accounting for the corporate rate reduction, the taxpayer's tax for the taxable year shall be increased by the amount by which it reduces its excess tax reserve more rapidly than permitted under a normalization method of accounting and the taxpayer will not be treated as using a normalization method of accounting for purposes of section 168(f)(2) and (i)(9)(C).[427]

The average rate assumption method[428] reduces the excess tax reserve over the remaining regulatory lives of the property that gave rise to the reserve for deferred taxes during the years in which the deferred tax reserve related to such property is reversing. Under this method, the excess tax reserve is reduced as the timing differences (*i.e.*, differences between tax depreciation and regulatory depreciation with respect to the property) reverse over the remaining life of the asset. The reversal of timing differences generally occurs when the amount of the tax depreciation taken with respect to an asset is less than the amount of the regulatory depreciation taken with respect to the asset. To ensure that the deferred tax reserve, including the excess tax reserve, is reduced to zero at the end of the regulatory life of the asset that generated the reserve, the amount of the timing difference which reverses during a taxable year is multiplied by the

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[427] Section 168(f)(2) and (i)(9)(C) provide that if a taxpayer is required to use a normalization method of accounting with respect to public utility property and does not do so, such taxpayer must compute its depreciation allowances for Federal income tax purposes using the depreciation method, useful life determination, averaging convention, and salvage value limitation used for purposes of setting rates and reflecting operating results in its regulated books of account.

[428] See section 2.04 of Rev. Proc. 88-12, 1988-1 C.B. 637.

ratio of (1) the aggregate deferred taxes as of the beginning of the period in question to (2) the aggregate timing differences for the property as of the beginning of the period in question.

The following example illustrates the application of the average rate assumption method. A calendar year regulated utility placed property costing $100 million in service in 2016. For regulatory (book) purposes, the property is depreciated over 10 years on a straight line basis with a full year's allowance in the first year. For tax purposes, the property is depreciated over 5 years using the 200 percent declining balance method and a half-year placed in service convention.[429]

Normalization calculation for corporate rate reduction
(Millions of dollars)
Year(s)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total
Tax expense	20	32	19.2	11.52	11.52	5.76	0	0	0	0	100
Book depreciation	10	10	10	10	10	10	10	10	10	10	100
Timing difference	10	22	9.2	1.52	1.52	(4.24)	(10)	(10)	(10)	(10)	0
Tax rate	35%	35%	21%	21%	21%	31.1%	31.1%	31.1%	31.1%	31.1%	
Annual adjustment to reserve	3.5	7.7	1.9	0.3	0.3	(1.3)	(3.1)	(3.1)	(3.1)	(3.1)	0
Cumulative deferred tax reserve	3.5	11.2	13.1	13.5	13.8	12.5	9.3	6.2	3.1	(0.0)	0
Annual adjustment at 21%						(0.9)	(2.1)	(2.1)	(2.1)	(2.1)	(9.3)
Annual adjustment at average rate						(1.3)	(3.1)	(3.1)	(3.1)	(3.1)	(13.8)
Excess tax reserve						0.4	1.0	1.0	1.0	1.0	4.5

The excess tax reserve as of December 31, 2017, the day before the corporate rate reduction takes effect, is $4.5 million.[430] The taxpayer will begin taking the excess tax reserve into account in the 2021 taxable year, which is the first year in which the tax depreciation taken with respect to the property is less than the depreciation reflected in the regulated books of account. The annual adjustment to the deferred tax reserve for the 2021 through 2025 taxable years is multiplied by 31.1 percent which is the ratio of the aggregate deferred taxes as of the beginning of 2021 ($13.8 million) to the aggregate timing differences for the property as of the beginning of 2021 ($44.2 million).

429 The 5-year tax and 10-year book lives are used for illustration purposes only. In general, public utility property may be depreciated over various periods ranging from 5 to 20 years under MACRS. For regulatory purposes, public utility property may, in certain cases, have a useful life of 30 years or more.

430 The excess tax reserve of $4.5 million is equal to the cumulative deferred tax reserve as of December 31, 2017 ($11.2 million) minus the cumulative timing difference as of December 31, 2017 ($32 million) multiplied by 21 percent.