CONCENTRIC ENERGY ADVISORS

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Impact of U.S. Federal Tax Reform on Regulated Utilities

United States President Donald Trump signed the Tax Cuts and Jobs Act (the "Act") into law on December 22, 2017. The Act, which will reduce the corporate tax rate to 21%, will have far-reaching implications for corporations. Investor-owned utilities will face unique challenges given the capital-intensive nature of their business.

Table 1: Major Provisions of the Tax Reform and Jobs Act

Tax Reform Provision	Rates and Regulatory Implications
Effective 2018	Anticipated that all state utility commissions will specifically address tax reform, preventing utilities from obtaining a financial windfall from the lower current income tax liability.
Implements a flat 21% Federal income tax and eliminates the Alternative Minimum Tax ("AMT")	Some states are already taking actions to capture the benefit of lower taxes for ratepayers.
Reduces the maximum deduction for Net Operating Losses ("NOLs"); allows NOLs to be carried forward indefinitely, but repeals the NOL carryback	Many utilities have large NOLs, resulting from years of bonus depreciation at the 35% corporate tax rate. These NOLs will likely be needed to offset taxable income much sooner than anticipated under the old tax law.
Limits the deduction of net interest to 30% of Adjusted Taxable Income ("ATI", approximately EBITDA through 2021, EBIT thereafter)	Utilities are specifically exempt from this restriction. Unregulated businesses will only be affected by the amount of interest that could have been deducted in excess of the 30% limit of ATI.
100% expensing of new investments (phased out starting in 2023)	Accumulated Deferred Income Tax ("ADIT") growth will slow as this repairs deduction is phased out tax depreciation is applied at the lower 21% rate.
ADIT Balances	Deferred taxes generated under the 35% rate will now be paid at the 21% rate. The Act requires utilities to establish a regulatory liability to credit ratepayers for the lower taxes payable in the future, thus lowering rates.

Expected Impact on the Utility

We expect that Tax Reform will impact utilities in the following areas:

1) Rates
2) Earnings
3) Rate base
4) Capital expenditures
5) State taxes (potentially)

Rates

All else being equal, we expect utility rates to go down as a result of the Act. The lower statutory federal income tax rate, once incorporated into utility revenue requirements, will more than offset increases in revenue requirements from rate base growth.

Earnings

In the short-term we expect utility earnings to increase if regulators do not take immediate action. As noted above, such situations will be limited, as regulators will want the benefits of the lower tax rate to flow back to ratepayers. Over the long term, earnings will increase commensurate with rate base growth from smaller deferred income tax offsets.

Rate Base

Utility rate base is expected to grow over the long run, as bonus depreciation is phased out and deferred income taxes are accrued at the lower tax rate.

Capital Expenditures

The Act will affect capital expenditure decisions differently for each utility, depending on their accumulated NOLs, type of planned expenditure (and its tax depreciation treatment), and the cash flows of the firm. The phase-out of bonus depreciation will make it more difficult for customer growth-related capital to be supported through incremental revenues.

State Taxes

Lastly, the Act may result in changes to state tax rates and policies. Most states rely on Federal Taxable Income to determine their tax obligations. With changes in deductions, states will look to determine whether their existing tax rates are sufficient.

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