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ALABAMA POWER
A SOUTHERN COMPANY

April 17, 2018

Alabama Public Service Commission
RSA Union Building
100 North Union Street, Suite 950
Montgomery, Alabama 36130

Attention: Mr. Walter L. Thomas, Jr.
Secretary

Re: Request for Accounting Authorization
Informal Docket No. U-________

Dear Commissioners:

By means of this letter, Alabama Power Company ("Alabama Power" or "Company") is requesting authorization from the Commission for regulatory accounting treatment related to the flow back to customers of certain federal excess deferred income taxes resulting from the recent passage of the Tax Cuts and Jobs Act ("TCJA")[1]. As discussed below, the Company seeks the authority to establish a regulatory liability in which it would place the flow back of the excess federal deferred income taxes otherwise included in the Company's income tax expense for the calendar year ending December 31, 2018 associated with the TCJA.[2] Further, the Company seeks the authority to create a regulatory asset in which it will record up to $30 million (i.e., an amount equivalent to the expected regulatory liability) of the under-recovered balance that would otherwise be included in the calculation of Rate ECR (Energy Cost Recovery). This request and the reasons for it have been discussed with the Commission's Staff, and the Company understands the Staff to be supportive of the issuance of the accounting authorization described herein.

Background

As with other public utilities, the Company must account for taxes associated with the timing of book expenses, as opposed to tax-return related expenses. This difference is reflected on the balance sheet as a deferred income tax account. From a conceptual standpoint, accumulated differences are initially built up in the account, but these differences are later drawn down and, assuming a constant tax rate, eventually net to zero. A change in the tax rates

[1] Tax Cuts & Jobs Act of 2017, Pub. L. No.115-97, 131 Stat. 2054 (2017).

[2] The exact amount is subject to change, as its calculation will include adjustments related to the calendar year ending December 31, 2018 that may be recorded in 2019 or thereafter as part of the finalization of income tax return filings.

between the time the deferred tax is recorded and the time it is drawn down results in an "excess" (if taxes are lowered) or "deficit" (if taxes are increased) balance in this account.

The TCJA was signed into law on December 22, 2017, with most provisions taking effect January 1, 2018. This legislation represents the most substantial revision to the Federal tax code in the last thirty years, bringing sweeping changes to individual, corporate and international tax law. One of the TCJA's most impactful changes is the reduction in the corporate tax rate from 35 percent to 21 percent. This reduction has resulted in a "mismatch" in the tax rates used to reconcile the timing differences described above, thus creating an excess amount of deferred taxes.[3]

The lowering of the federal tax rate resulted in an additional regulatory liability associated with excess deferred federal income taxes of approximately $2.1 billion at December 31, 2017. Beginning with 2019, flow back of these deferred taxes will be included in the annual calculations under Rate RSE and thus reflected in retail cost of service. As the Rate RSE filing for 2018 preceded enactment of the TCJA, the Company expects there to be approximately $30-$50 million (or $40-$70 million on a pre-tax basis) of excess deferred federal income taxes applicable to calendar year 2018, with the actual amount dependent on finalization of the Company's federal income tax obligations for that year. The Company proposes to use this excess amount for the benefit of customers, as described below.[4]

<u>Requested Regulatory Accounting Treatment</u>

To enable the Company to apply to the benefit of customers the excess federal deferred income taxes resulting from the effects of the TCJA on its 2018 tax obligations, Alabama Power is requesting the following accounting authorization from the Commission. Specifically, the Company requests authority to establish a regulatory liability account in which to record the excess federal deferred income taxes associated with the TCJA for the calendar year ending December 31, 2018. The Company also requests authority to create a regulatory asset account in which it will record up to a $30 million equivalent to the regulatory liability described above, which would correspond to under-recovered balances that would otherwise be included in the calculations of Rate ECR.[5] The Company then will amortize the balances in the regulatory asset account created above consistent with the manner by which the affected excess federal deferred

[3] The Internal Revenue Service ("IRS") has classified excess deferred taxes into two categories: protected and unprotected. The protected deferred taxes generally relate to accelerated depreciation, and under IRS regulations must be flowed back to customers over a prescribed period of time. Unprotected deferred taxes do not fall under these regulations and therefore other regulatory treatment is permissible.

[4] Contemporaneously with this filing, the Company is submitting to the Staff its calculation of the Income Tax Adjustment Percentage ("ITAP") under Rate T (Tax Adjustment). This mechanism will result in a refund to customers of the direct after-tax revenue effect of the lower federal tax rate, which was not reflected in the Rate RSE submittal for calendar year 2018. The ITAP will be applied to customer bills for July through December 2018, and equates to a 9.026 percent reduction to billings (or approximately $257,441,000). The ITAP submitted by the Company does not reflect the excess federal deferred income taxes applicable to calendar year 2018, as addressed in this accounting request.

[5] The actual amount to be recorded in the regulatory asset will depend on the actual amount placed in the regulatory liability, which as noted will not be known until later in 2019, at the earliest.

income taxes would otherwise have flowed back to customers, thus having no impact on net income.

As noted earlier, the actual amount of excess federal deferred income taxes associated with the TCJA for the calendar year ending December 31, 2018 will not be known until the Company's tax liability for that year is finalized. Pending such finalization, estimated amounts will be recorded in the regulatory liability account, with offsetting entries in the regulatory asset account (up to $30 million). In the event that the actual flow back of the excess federal deferred income taxes associated with the TCJA exceeds the $30 million equivalent recorded in the regulatory asset, the Company will record the remainder of that actual flow back amount in the regulatory liability, with the expectation that the Commission would direct the Company to reduce the aforementioned regulatory liability in a manner it deems beneficial to customers.[6]

If the Commission or its Staff has any questions concerning this request, or if additional information is needed, please contact me or Mr. Richard Hutto (205.257.2941).

Sincerely,

[6] In the event the actual amount of flow back of the excess federal deferred income taxes associated with the TCJA is less than $30 million, appropriate reversing adjustments will be made to the associated Rate ECR balance to match that actual amount.