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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

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RELEASED

AUG 27 1976

The Honorable Lee Metcalf, Chairman  
Subcommittee on Reports, Accounting,  
and Management  
Committee on Government Operations  
United States Senate

SEN 01505

Dear Mr. Chairman:

Your October 3, 1975, letter asked us to determine the amount of Federal income taxes paid by class A and B electric utilities, using the tax data they supplied to the Federal Power Commission. In addition, you asked us to explain (1) any differences between the Federal income taxes paid and the Federal income taxes charged as furnished to you by the Commission and (2) the open audit system used by the Internal Revenue Service (IRS) concerning such taxes.

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In later meetings with your office, we agreed to seek disclosure of the tax data from IRS because we could not determine with any degree of accuracy the amount of tax paid by electric utilities from the data they supplied to the Commission. We were also asked to inquire into the open-year audit or any other IRS audit procedures which were peculiar to the electric industry which would be responsible for differences.

We agreed that the tax data to be obtained from IRS was the status of accounts which disclosed the tax liability and the tax paid documented by official tax returns for each utility company but which would not have complete tax data about subsequent credits, deferrals, and intracorporate adjustments.

The Commission tax data given you is derived from tax data that electric utilities filed annually on FPC Form 1. Although form 1 contains an estimate of the electric utilities' tax liability based on income and expenses accumulated as of December 31 of any reporting year, such an estimate may reflect information and adjustments to taxes paid in more than one reporting year. This appears to be caused by differences in the Commission and IRS reporting requirements. Over a period of several years, however, the tax data from the form 1 should coincide with taxes paid.

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The open audit system mentioned in your letter appears to apply to an open year. This term considers a utility company's ability to change or make adjustments to its taxes in a year which has not been fully audited by IRS. The ability to change or make adjustments to taxes is not peculiar to utility companies. According to IRS, electric utility companies are generally taxed like other corporations, and the various types of audit adjustments made to the income tax returns of utility companies may also be made to the income tax returns of other corporations.

In December 1975 we requested the tax data from IRS on taxes paid in 1972, 1973, and 1974 by electric utilities subject to Commission jurisdiction.

Of the 214 electric utility companies under the Commission jurisdiction for which IRS provided us income tax data, we could not determine the tax liability or the amount of tax paid for 10 utility companies because their income tax data was integrated with tax data of unregulated industries. The other 204 utility companies paid Federal income taxes of about \$792 million in 1972, \$798 million in 1973, and \$578 million in 1974 for a total of about \$2.2 billion during the 3-year period. Although these amounts appear to be close to the amounts the Commission gave you as Federal income taxes charged, such similarity is mostly coincidental.

Our analysis of the IRS tax data and the individual utility companies tax data supplied to the Commission showed many wide disparities. Only in about one-third of the individual cases do the figures reported to the Commission and IRS over the 3-year period come within 10 percent of each other. Although we did not attempt to account for the differences in each case, we noted that some were caused by the differences in the Commission and IRS reporting requirements.

The bill, which you introduced in 1975 to abolish Federal income taxation of electric utilities (S. 2213), is predicated, in part, on the assumption that rates paid by consumers include an amount of income tax which is not actually paid by electric utilities.

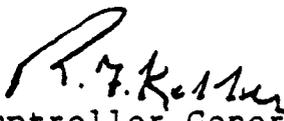
There may be significant differences in the tax data as supplied by the Commission or IRS and the tax liability used to justify the rates consumers must pay. Generally consumer rates are based on the cost of service, a fair

rate of return, and Federal income taxes on the return computed at a statutory amount of 48 percent of pretax income as applied to future energy sales volumes. Fluctuations in the sales volumes and cost of service as well as various tax statutes cause the actual taxes and the tax liability used for rate justification to vary.

We recognize that taxes are an important part of electric utilities' rates. The consideration of electric utilities' taxes is an integral part of the Commission's ratemaking procedures. We are making a comprehensive survey of rate-making activities during which we will evaluate the propriety of the costs used to establish consumer rates. We will send you a copy of any report that may result in this area.

We discussed the foregoing information with officials of the Commission's Office of Accounting and Finance and Bureau of Power who generally concurred.

Sincerely yours,

  
ACTING Comptroller General  
of the United States