Public Service Co. of New Hampshire v. Commissioner of Internal Revenue, 78 T. C. 445 (1982)

A utility company's method of accounting for tax purposes can differ from its financial accounting if it clearly reflects income and has been consistently applied.

Summary

Public Service Company of New Hampshire, a regulated electric utility, used the meter reading and billing cycle method for tax reporting, which deferred recognition of income from electricity used but not billed in December until the following year. The IRS challenged this, citing a lack of uniformity with the company's financial statements that recorded estimated unbilled revenue. The Tax Court upheld the utility's method, emphasizing its long-standing use, industry acceptance, and clear reflection of income, despite the mismatch with financial accounting practices.

Facts

Public Service Company of New Hampshire (PSNH) operated as a regulated electric utility, using the accrual method for tax reporting and the meter reading and billing cycle method for sales of electricity. This method allowed PSNH to not report as income the sales of electricity used after the last meter reading in December until the following year when bills were issued. However, for financial and book accounting, PSNH recorded an estimate of this unbilled revenue. The IRS challenged this practice, claiming a lack of uniformity between tax and financial accounting under Rev. Rul. 72-114.

Procedural History

PSNH had used the meter reading and billing cycle method since at least 1934, and this method was examined and accepted during audits in 1934 and 1938. The IRS did not challenge this method until 1974, leading to the current dispute. The Tax Court considered whether this method clearly reflected income under Section 446(b) of the Internal Revenue Code.

Issue(s)

1. Whether the meter reading and billing cycle method of accounting used by PSNH for tax purposes, which differs from its financial accounting treatment, clearly reflects its income under Section 446(b) of the Internal Revenue Code.

Holding

1. Yes, because the method had been consistently used by PSNH since at least 1934, was accepted in the industry, and clearly reflected income despite not matching the financial accounting treatment of unbilled revenue.

Court’s Reasoning

The Tax Court focused on whether PSNH’s method clearly reflected income under Section 446(b). It considered factors such as the method’s consistency over time, its alignment with industry practices, and its general acceptance as a method that reflects income. The Court noted that PSNH had used this method since at least 1934, and it had been accepted in previous audits. Furthermore, a majority of major public utilities used similar methods, and the IRS had recognized these practices in Rev. Rul. 72-114. The Court also acknowledged the mismatch between recognizing expenses in the year incurred and deferring income until billed but found this not determinative, citing precedents where such mismatching was permissible. The Court concluded that the IRS’s challenge to PSNH’s method was an abuse of authority given the method’s clear reflection of income.

Practical Implications

This decision allows regulated utilities to use the meter reading and billing cycle method for tax purposes, even if it differs from their financial accounting, as long as it clearly reflects income. It emphasizes the importance of consistency and industry practice in determining the appropriateness of an accounting method. Legal practitioners should note that the IRS’s discretion under Section 446(b) is limited when a taxpayer can demonstrate long-standing use and industry acceptance of an accounting method. This ruling may encourage utilities to maintain distinct accounting practices for tax and financial reporting, particularly when industry standards support such differentiation. Subsequent cases, such as Bay State Gas Co. v. Commissioner, have built on this decision, further clarifying the application of accounting methods in regulated industries.

