Consumers Power Co. v. Commissioner, 89 T. C. 710, 1987 U. S. Tax Ct. LEXIS 139, 89 T. C. No. 49 (1987)

The meter reading and billing cycle method of accruing utility income qualifies as a "meters-read" method under the Tax Reform Act of 1986.

Summary

Consumers Power Co. used a meter reading and billing cycle method to accrue utility income for tax purposes, which involved accruing income based on monthly meter readings across 21 districts over 12 billing cycles. The IRS challenged this method, advocating for a full-accrual method. The Tax Court held that the company's method qualified as a "meters-read" method under the Tax Reform Act of 1986, which deemed such methods proper for tax years before 1987. Additionally, the court ruled that the Ludington Pumped Storage Hydroelectric Plant was not placed in service in 1972 for depreciation and investment credit purposes, as it was not fully operational until January 1973.

Facts

Consumers Power Co. , a Michigan-based utility company, used the meter reading and billing cycle method to accrue utility income for tax purposes. This method involved reading customer meters monthly across 21 districts, with each district assigned a specific day for meter reading within a billing cycle. The company accrued income from 250 out of 252 meter-reading days in a year, with the remaining two days' income accrued in the following year. The IRS audited the company and sought to change its accounting method to the full-accrual method for tax purposes. Additionally, Consumers Power Co. began constructing the Ludington Pumped Storage Hydroelectric Plant in 1969 with Detroit Edison Co. The plant's unit 1 underwent preoperational testing in 1972, but a mechanical failure occurred on December 7, 1972, delaying full operation until January 1973.

Procedural History

The IRS issued a notice of deficiency to Consumers Power Co. for the tax years 1968 through 1974, challenging the company's method of accruing utility income and the placed-in-service date of the Ludington Plant. The company filed a petition with the U. S. Tax Court to contest the deficiencies. The Tax Court consolidated cases involving Consumers Power Co. and its subsidiaries.

Issue(s)

1. Whether Consumers Power Co. 's method of accruing utility income qualifies as a "meters-read" method under section 821(b)(3) of the Tax Reform Act of 1986?
2. Whether the Ludington Pumped Storage Hydroelectric Plant was placed in service in 1972 for purposes of depreciation and the investment credit?

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Holding

1. Yes, because Consumers Power Co. ‘s method of accruing utility income, which involved accruing income based on monthly meter readings across 21 districts, effectively treated income as accrued in the same year the meters were read, qualifying as a “meters-read” method under the Tax Reform Act of 1986.
2. No, because the Ludington Plant was not in a state of readiness and availability for its specifically assigned function until January 1973, after unit 1 completed all preoperational testing.

Court’s Reasoning

The Tax Court reasoned that Consumers Power Co. ‘s method of accruing utility income was a variation of the “meters-read” method, as it accrued income based on monthly meter readings. The court emphasized the remedial nature of section 821(b)(3) of the Tax Reform Act of 1986, which intended to minimize disputes over prior taxable years by deeming the “meters-read” method proper. The court found that the company’s method, which accrued income from over 99% of its customers in the same year as the meter readings, qualified for relief under the Act. Regarding the Ludington Plant, the court applied the “placed in service” rules from the regulations, concluding that the plant was not available for regular operation until January 1973, as preoperational testing was not completed until then. The court also rejected the company’s argument that the upper reservoir should be considered separately for depreciation and investment credit purposes, as the plant’s components functioned as a single unit.

Practical Implications

This decision clarifies that utility companies using variations of the meter reading and billing cycle method for accruing income can qualify for relief under the Tax Reform Act of 1986, provided the method effectively treats income as accrued in the same year as the meter readings. Legal practitioners should consider this ruling when advising utility clients on accounting methods for tax purposes, particularly for years before 1987. The decision also reinforces the “placed in service” test for depreciation and investment credit purposes, emphasizing that assets must be fully operational and available for their intended function before deductions can be claimed. This ruling may impact how utility companies approach the timing of depreciation and investment credit claims for large projects, ensuring that all components are operational before claiming such benefits.

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