State of South Carolina
Department of Revenue
301 Gervais Street, P.O. Box 125, Columbia, South Carolina 29214

SC REVENUE PROCEDURE #04-5

SUBJECT: Procedure for Determining Depreciation for Electric Company Personal Property under Fee in Lieu of Property Tax Agreements (Property Tax)

EFFECTIVE DATE: Applies to all periods open under the statute.

REFERENCE: S.C. Code Ann. Section 4-12-30(D)(2)(a)(ii) (Supp. 2003)
S.C. Code Ann. Section 4-29-67(D)(2)(a)(iii) (Supp. 2003)
S.C. Code Ann. Section 12-44-50(A)(1)(c) (Supp. 2003)

AUTHORITY: S.C. Code Ann. Section 12-4-320 (2000)
S.C. Code Ann. Section 1-23-10(4) (Supp. 2003)
S.C. Revenue Procedure #03-1

SCOPE: The purpose of a Revenue Procedure is to provide procedural guidance to the public and Department personnel. It is a written statement issued to assist in the administration of laws and regulations by providing guidance that may be followed in order to comply with the law. **A Revenue Procedure is an advisory opinion; it does not have the force or effect of law and is not binding on the public.** It is, however, binding on agency personnel until superseded or modified by a change in statute, regulation, court decision, or advisory opinion.

Questions have arisen regarding the appropriate depreciation rate to be assigned to the personal property of electric companies[1] covered under a fee in lieu of property tax (Fee) agreement. The purpose of this document is to set forth a procedure by which the depreciation rate is to be determined for electric company personal property under the Fee. [2]

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[1] Electric companies include companies that provide electric generation, electric transmission, or electric distribution or any combination of them, it includes both companies regulated by the Public Service Commission (PSC) as well as those that are not regulated by the PSC.

[2] To the extent that an electric company has real property that is subject to the fee, Sections 4-12-30(D)(2)(a)(i); 4-29-67(D)(2)(a)(iii); and 12-44-50(A)(1)(c)(i) of the South Carolina Code of Laws ("Code") requires that such real property be valued at income tax basis without any allowance for depreciation**.**

The three fee provisions, Code Sections 4-12-30, 4-29-67, and 12-44-50, in the South Carolina Code have identical language when referring to the depreciation method that should be used for valuing personal property under a Fee. This language states that personal property will be valued using "the original tax basis for South Carolina income tax purposes less depreciation allowable for property tax purposes." See S.C. Code Ann. Sections 4-12-30(D)(2)(a)(ii); 4-29-67(D)(2)(a)(iii); and 12-44-50(A)(1)(c).

Although the South Carolina Code does not specify a depreciation rate to be used by electric companies for depreciating personal property for property tax purposes[3], it has been the longstanding administrative policy of the Department to use the overall composite depreciation rate for the electric company, and, if applicable, the Department has accepted the composite depreciation rate approved by the Public Service Commission (PSC). Administrative interpretations of statutes by the agencies charged with their administration and not expressly changed by statute, are entitled to great weight. *Marchant v. Hamilton*, 279 S.C. 497, 309 S.E. 2d 781 (1983).

Since a composite depreciation rate is used for valuing electric companies for property tax purposes, a composite depreciation rate should also be used for valuing electric company property within a Fee agreement pursuant to Code Sections 4-12-30(D)(2)(a)(ii); 4-29-67(D)(2)(a)(iii); and 12-44-50(A)(1)(c). However, with a Fee transaction, only certain assets are subject to the Fee and therefore, only those assets subject to the Fee should be used in computing the composite rate to be applied to the personal property assets that are subject to the Fee.

Where applicable, electric companies should compute a composite depreciation rate based upon the rates and useful lives approved by the PSC but computed exclusively on the personal property that is subject to the Fee. The depreciation rates approved by the PSC are based upon detailed depreciation studies provided by the electric company. The electric company should compute a composite rate on the personal property in the Fee in a similar manner as the method required by the PSC.

All electric companies must provide a depreciation study for all property subject to the Fee to the Department in support of their requested depreciation rate for Fee purposes with their first fee return. Such study should be similar in content to those which certain electric companies are required to provide to the PSC. Based upon this study, the electric company would calculate a composite depreciation rate to be applied to all personal property in the Fee agreement. The Department will review this information and may require additional information or may conduct a study of its own.

The method described below is a method that is similar to the method the PSC has sanctioned for the purpose of computing composite depreciation rates for PSC purposes.

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[3] The SC Code and Regulations do provide depreciation methods for merchants as defined in SC Code section 12-43-335 and 12-39-70, and manufacturers as defined in SC Code section 12-43-335. See SC Code section 12-37-930 and SC Reg. section 117-110 for these depreciation methods.

However, for purposes of the Fee, only personal property covered by the Fee agreement should be included in the computation. [4]

COMPUTATION OF COMPOSITE DEPRECIATION RATE

The first step is to determine the annual depreciation for each item of personal property subject to the Fee. The depreciation studies provided by electric companies to the PSC calculate depreciation rates for individual items of equipment on a straight line basis by using the following formula:

$$(1 - \text{net salvage } \%) / \text{average service life}$$

This depreciation rate is then applied to the original cost for each piece of property to determine the annual depreciation allowed for each piece of property. Note, this is not the final depreciation rate to be applied to determine the value of personal property subject to the Fee, but it is the first step in determining the composite depreciation rate that will ultimately be used.

Next, add together the previously computed cost for each piece of property under the fee agreement. Likewise, add together the previously computed annual depreciation for each piece of property. The total of the annual depreciation is then divided by the total cost of the property under the Fee agreement to arrive at a composite depreciation rate. Each year additions must be added, and retirements must be subtracted, as property is added and removed from the Fee. All computations should be carried out to three decimal places and rounded to two decimal places.

As a matter of convenience, a taxpayer may find it easier to group like assets together and determine a composite depreciation rate for that group of assets. To do this, the total annual depreciation for all personal property under the Fee agreement for that type of production would be divided by the total of all the original cost for personal property within the Fee agreement and for that type of production to arrive at a composite depreciation rate for each type of production. Then, the previously computed total cost for each type of production within the Fee agreement would be added together. Likewise, the previously computed total annual depreciation for each type of production would be added together. The total of the annual depreciation (as just computed) for all types of production would then be divided by the total cost of all of the property under the Fee agreement for all types of production to arrive at a composite depreciation rate of all of the previously computed composites. Grouping of the assets by type of production for convenience has been done in the example below.

[4] Buildings and structures that are classified as real property would not be included in this group of assets.

The last step is to apply the composite depreciation rate determined above to the original income tax basis of each piece of personal property subject to the fee to determine the value of the property for Fee purposes. The depreciation floor to be utilized by utilities under a Fee is the same as used by utilities for property not under a Fee. The composite rate will need to be recalculated each year as property is added to, and removed, from the Fee.

SAMPLE COMPUTATION

To illustrate the above composite rate computation, please refer to the example below. Assume that all of the personal property listed below is covered under a Fee.

Step 1: Compute the annual depreciation for each piece of personal property under the Fee.

Steam Production
X Facility

Boiler Equipment	Original Cost	Depreciation Rate Per Study	Annual Depreciation
Boiler #1	$16,000,000	(1-15%) / 30 = 2.83%[5]	$ 452,800
Boiler #2	$18,000,000	(1-20%) / 20 = 4.00%	$ 720,000
Boiler #3	$25,000,000	(1- 5%) / 40 = 2.38%	$ 592,500
Total	$59,000,000		$1,765,300

Steam Production
X Facility

Turbogenerators	Original Cost	Depreciation Rate Per Study	Annual Depreciation
Turbogenerator #1	$ 5,000,000	(1-15%) / 30 = 2.83%	$141,500
Turbogenerator #2	$10,000,000	(1-5%) / 25 = 3.80%	$380,000
Turbogenerator #3	$35,000,000	(1-20%) / 45 = 1.78%	$619,500
Total	$50,000,000		$1,141,000

[5] The depreciation rate per study is the net salvage value for the property subtracted from 100 and then divided by the useful life for the property. For example, for Turbogenerator #1, the formula is 100 – a net salvage value of 15, divided by the useful life of the property (30 years) to get a yearly depreciation ratio of 2.83%.

Step 2: Compute composite depreciation rate

Steam Production X Facility	Composite Value	Composite Depreciation %	Annual Depreciation
Total Boiler Equipment	$ 59,000,000		$1,764,100
Total Turbogenerators	$ 50,000,000	———	$1,140,000
Final Composite Amount	$109,000,000	2.66%*	$2,904,100

*This amount is computed by dividing $2,904,100 by $109,000,000

Step 3: The composite depreciation rate is applied to the original South Carolina income tax basis for each piece of personal property subject to the Fee. In the example above, the depreciation rate to be used for all personal property under the Fee is the final composite calculation of 2.66%. The depreciation rate will need to be recalculated each year if additional property is added to the fee or property is removed from the fee in order to determine the composite depreciation rate for that year.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Burnet R. Maybank III
Burnet R. Maybank III, Director

September 28, 2004
Columbia, South Carolina