SURFACE TRANSPORTATION BOARD
Office of Economics
Washington, DC 20423

March 20, 2018

Jason A. Zampi
Assistant Vice President Corporate Accounting
Norfolk Southern Corporation
Three Commercial Place
Norfolk, VA 23510-2191

Dear Mr. Zampi,

Pursuant to 49 C.F.R. § 1011.6(f) and 49 C.F.R. § 1201, Instr. 1-2(d)(7)), I have considered your letter of March 5, 2018 to Pedro Ramirez, Branch Chief, Section of Data Collection and Auditing. Your letter requests approval to treat adjustments to Norfolk Southern's (NS) Deferred Income Tax Liability that occurred in 2017 due to the enactment of the *Tax Cuts and Jobs Act*[1] as extraordinary items in NS's financial reports to the Board. For the reasons discussed below, your request will be denied.

The Board's regulations set a high bar for the use of the extraordinary item account. Profits and losses during a reporting year "are includable in ordinary income unless evidence *clearly supports* their classification as extraordinary items." 49 C.F.R. § 1201, Instr. 1-2(d)(1) (emphasis added). To be considered for this classification, an item must meet the following criteria:

(1) it must be *unusual*, meaning that it possesses a high degree of abnormality and is of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the carrier;
(2) it must be *infrequent*, meaning that it is not reasonably expected to recur in the foreseeable future; and
(3) it must be *material*.

The Board's regulations provide that carriers shall follow Generally Accepted Accounting Principles (GAAP) where an interpretation of the Board's extraordinary items classification is

[1] Pub. L. No. 115-97 (2017).

needed, or alternatively that carriers can obtain an interpretation from an accountant or the Board. *See* Note, 49 C.F.R. § 1201, Instr. 1-2(d)(7).

In 2015, GAAP was changed to eliminate the extraordinary items classification.[2] Thus, at this time, the Board's Uniform System of Accounts (USOA) differs from GAAP as to the availability of this classification.[3]

Regardless of the difference between GAAP and the USOA on the specific issue of extraordinary items, a separate GAAP rule regarding the reporting of changes in tax rates would appear to effectively prohibit the accounting treatment requested in your letter. Clear GAAP standards in place both before and after the 2015 elimination of extraordinary items require that adjustments to deferred tax accounts "for the effect of a change in tax laws or rates . . . shall be included in income from continuing operations for the period that includes the enactment date." *FASB Accounting Standard Codification (ASC) 740-10-45-15* (governing the treatment of changes in tax laws and rates); *see also* prior FASB Statement 109 (1992) (stating that the tax effects of changes in lax laws or rates "is included in income from continuing operations"). Accordingly, GAAP appears to have long prohibited the use of non-continuing operations classifications, such as extraordinary items, for changes in tax rates and the USOA provides that carriers shall follow GAAP with regard to reporting income taxes. 49 C.F.R. § 1201, Instr. 1–10, Note B. NS fails to discuss whether it is permissible under GAAP to depart from this requirement based solely on the magnitude of the tax rate change. Under these circumstances, I cannot conclude that the evidence "clearly supports" the use of USOA's extraordinary item account.

Even if there did not appear to be an outright GAAP prohibition on reflecting tax rate changes in anything other than ordinary income, NS has not provided clear support for the use of the USOA's extraordinary item account here. It may be that the adjustments identified in your letter, which amount to approximately $3.4 billion for NS in 2017, meet the Board's materiality standard. But NS has not clearly established that the unusual and infrequent criteria are satisfied.

First, changes in tax rates, as a general matter, may not satisfy the criterion that they be unusual. Including the 2017 *Tax Cuts and Jobs Act*, the top corporate tax rate has been changed 33 times in the last 109 years.[4] While it is true that the magnitude of the reduction in the

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[2] *See Financial Accounting Standards Board (FASB) Accounting Standards Update 2015-01 Income Statement—Extraordinary and Unusual Items* (Subtopic 225-20) (*ASU*).

[3] I do note that GAAP currently permits unusual and/or infrequent items to be presented as a separate component of income from continuing operations or disclosed in notes to financial statements. *See ASU* at 225-20-50-1.

[4] See *Corporation Income Tax Brackets and Rates, 1909-2002, IRS Data Release*, available at https://www.irs.gov/pub/irs-soi/02corate.pdf.

corporate tax rate in the *Tax Cuts and Jobs Act* was quite large (14 percentage points), the agency has held that it is the nature of the event, not its magnitude, that governs its treatment as unusual.[5] Moreover, because tax policy is subject to complicated economic and political considerations, it would be very difficult to ever know whether adjustments are reasonably likely to recur in the foreseeable future under the infrequency criterion. I also note that the letter from NS's independent accountant neither approved the use of the extraordinary item account nor commented in such a way to indicate that the unusual or infrequent criteria were fully satisfied.

The agency's experience with the 1986 adjustment to the corporate tax rate is also instructive. Carrier financial reports to the Interstate Commerce Commission (ICC) from that period show the inclusion of the similarly-sized 1986 reduction in the corporate tax rate (12 percentage points) in Account 557 (Provision for Deferred Taxes), not Account 591 (Provision for Deferred Taxes – Extraordinary Items).[6]

For the reasons stated above, your request is denied. Of course, consistent with GAAP and the USOA, you are free to disclose the change in NS's deferred taxes as a note to your R-1 and other STB reports, which should address NS's concern that users of financial data have information to "facilitate making period-to-period comparisons."

Respectfully,

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[5] *Western Coal Traffic League v. Union Pacific Railroad*, FD 33726, slip op. at 4-5 (STB served Nov. 30, 2000).

[6] The ICC addressed the question of how the tax rate adjustments should be treated in the context of particular regulatory proceedings. *See Railroad Revenue Adequacy – 1988 Determination, Motion of Edison Electric Institute for Reconsideration*, EP 483 (ICC served Jan. 22, 1991).