

ORDER NO. 151

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Before Commissioners:

Dan G. Blair Chairman;  
Nanci E. Langley, Vice Chairman;  
Mark Acton;  
Ruth Y. Goldway; and  
Tony L. Hammond

Accounting Practices and Tax Rules for  
Competitive Products

Docket No. RM2008-5

ORDER ESTABLISHING ACCOUNTING PRACTICES  
AND TAX RULES FOR COMPETITIVE PRODUCTS

(Issued December 18, 2008)

I. INTRODUCTION AND SUMMARY

This order establishes financial accounting practices and tax rules for competitive products. The Postal Accountability and Enhancement Act (PAEA), Pub. L. 109-435, 120 Stat. 3218 (2006), requires the Commission to prescribe rules applicable to competitive products for the establishment and application of (a) the accounting practices and principles to be followed by the Postal Service, and (b) the substantive and procedural rules for determining the assumed Federal income tax on competitive products income. See 39 U.S.C. 2011(h)(2)(B). In addition, such rules shall provide for the submission by the Postal Service of annual and other periodic reports setting forth such information as the Commission may require. 39 U.S.C. 2011(h)(2)(B)(i)(III).

Aided by recommendations contained in a report submitted by the Secretary of the U.S. Department of Treasury (Treasury) pursuant to the PAEA, as well as comments on that report provided by interested persons, including the Postal Service, the Commission issued Order No. 106 which proposed rules for implementing 2011(h)(2)(B).<sup>1</sup> The proposed rules attempt to give effect to section 2011 in the context of the PAEA as a whole, while recognizing the realities and complexities of the Postal Service's operations and the legitimate expectations of stakeholders. Interested persons were invited to comment on the proposed rules. The Postal Service and the Public Representative filed initial comments on October 20, 2008, and reply comments on November 3, 2008. The final rules in this order differ from the rules proposed in Order No. 106 in minor ways designed to clarify the rules in response to the comments received. Principal differences between the proposed and final rules are:

- Treatment of group specific costs when calculating net income for competitive products has been changed to be consistent with PRC Order No. 115;
- The title for the Pro Forma Balance Sheet has been changed to Statement of Allocated Assets and Liabilities for Competitive Products;
- The due dates for all financial reports will be within 90 days of the close of the fiscal year, with the exception of the first year in which certain reports are due by January 15, 2009;
- The first Statement of Allocated Assets and Liabilities for Competitive Products is due within 90 days of the close of FY 2010;
- The definition of assumed taxable income from competitive products has been changed to include an adjustment for permanent items;
- The refund of a prior year's assumed tax payment resulting from the carry back of a Net Operating Loss will be the lesser of (1) the tax payment in the prior two years, or (2) the hypothetical tax computed on the amount of the loss.

---

<sup>1</sup> PRC Order No. 106, Order Proposing Accounting Practices and Tax Rules for Competitive Products, September 11, 2008.

- An opportunity for public comment on the Postal Service's assumed annual Federal income tax calculation is provided.

Among the goals of the PAEA are the following: (1) increase the transparency of Postal Service operations; (2) prohibit cross-subsidies of competitive products by market dominant products; and (3) reduce administrative burdens. In developing the proposed rules and in establishing the final rules, the Commission has been guided by these goals.

The final rules, like the proposed rules, are based on a theoretical, on-paper-only enterprise, do not require new accounting or data collection systems, maintain the Commission's existing definition of attributable cost, and provide the Postal Service optional means for calculating an assumed Federal income tax on competitive products income. They are, in short, intended to promote the goals of transparency and accountability without imposing undue burdens on the Postal Service.

The assumed Federal income tax is an intra-agency transfer designed to foster fair competition, a goal also served by the PAEA's pricing provisions applicable to competitive products. See 39 U.S.C. 3633(a)(1)-(3). The statute requires the annual "payment" of an assumed Federal income tax from the competitive products fund to the general postal fund, and these rules implement that requirement. See 39 U.S.C. 3634(b).

## II. COMMENTS REGARDING THE PROPOSED RULES

Two parties—the Postal Service and the Public Representative—filed initial and reply comments in response to Order No. 106. In addition to suggesting clarification in language and deadlines, the Postal Service requests a change in the way group specific costs are to be treated in the calculation of net income for competitive products. The Postal Service also proposes a new source for an effective tax rate to be used in the simplified approach to calculating an assumed Federal income tax on competitive products. Finally, the Postal Service questions the value of the proposed Pro Forma Balance Sheet and requests the name of this report be changed.

The Public Representative suggests that the Commission open a docket each year to provide notice of receipt of the required periodic reports and to solicit public comment on those reports. The Public Representative also proposes language changes to clarify, and in one instance to correct, the proposed tax rules. The Postal Service agrees with the proposed correction.

### III. ACCOUNTING PRACTICES AND REPORTING REQUIREMENTS

The Commission's proposed rules regarding accounting practices and procedures associated with providing competitive products focus on the costing methodology to be used by the Postal Service; methods for valuing assets and liabilities; and the financial reporting requirements for the competitive products enterprise. In this section, the Commission addresses the parties' comments concerning the accounting principles and reporting requirements embodied in the proposed rules.

#### A. Treatment of Group Specific Costs

The treatment of group specific costs has been changed in the final rules to make it consistent with Order No. 115.<sup>2</sup> Order No. 115 was issued subsequent to the drafting of the proposed accounting rules and addressed group specific costs in a much broader context than proposed rule 3060.21. The Commission noted in Order No. 115 that treatment of group specific costs for accounting purposes would have to be revisited in the final accounting rules.

The Postal Service notes that proposed rule 3060.21, which sets out the format for the Competitive Products Income Report, is inconsistent with the treatment of group specific costs in Order No. 115. Group specific costs are costs that are related to a specific line of business, such as competitive products, but which cannot be attributed to

---

<sup>2</sup> Docket No. RM2008-2, Order No. 115, Order Accepting Certain Analytical Principles for Use in the Postal Service's Periodic Reports, October 10, 2008, at 9-19.

one product. Costs related to a manager that oversees all competitive products and does not work on market dominant products at all is an example.

In the proposed rule, Net Income is defined as Total Revenue minus Total Competitive Products Attributable Costs minus Required Institutional Cost Contribution. Total Competitive Products Attributable Costs, as used in proposed rule 3060.21, include Group Specific Costs. Order No. 115 set forth the Commission's rationale for not removing group specific costs from institutional costs until such time as a comprehensive and thorough analysis of group specific costs has been completed. The Postal Service points out that if rule 3060.21 treats institutional costs in the same manner as Order No. 115, there will be a duplicate expense deduction for group specific costs.

Order No. 115 was concerned with the rationale for group specific costs in an economic rather than an accounting sense. In that order, the Commission concluded that the use of group specific costs was acceptable as an interim tool for applying the incremental cost test to the revenues of the competitive products enterprise. However, their use was not acceptable as a means of calculating an economically meaningful measure of institutional costs, particularly since the Postal Service has yet to complete a comprehensive analysis of group specific costs for both competitive and market dominant products and was proposing to identify and isolate group specific costs in an evolutionary manner.

For pricing, marginal costs (*i.e.*, volume variable costs) are needed and when testing for cross-subsidy, incremental costs are the generally accepted basis. Calculating the cost of a firm for tax purposes is fundamentally different from calculating costs for pricing or for testing for cross-subsidization. For tax purposes, the total cost of the firm is required.

In proposed rule 3060.21, the Commission suggests that the total cost of the Postal Service's competitive products enterprise equals the sum of volume variable costs, product specific costs, group specific costs, and the appropriate share of institutional costs. The Commission agrees with the Postal Service that the group

specific costs should be removed from the institutional costs before applying the appropriate percent. See Docket No. PI2008-2, Initial Comments of the United States Postal Service in Response to Order No. 56 and the Treasury Report, April 1, 2008, at 12-15.

In an accounting sense, costs which cannot be allocated specifically to one segment of a business are referred to as joint production costs. In the case of the Postal Service, these costs would necessarily exclude group specific costs for both competitive and market dominant product groups since these costs have been identified as being causally related to a specific line of business. Because a comprehensive analysis of group specific costs has not yet been completed, the Commission believes that institutional costs are the best available proxy for joint production costs. In the future, the appropriate percent of joint production costs that are allocated to competitive products may be greater or less than the 5.5 percent currently applied to total institutional costs, which was based on historical cost coverages rather than the concept of causation.<sup>5</sup> An appropriate share of joint production costs may be developed using market-based data such as revenue or physical measures such as volume or weight.<sup>6</sup>

To be consistent with Order No. 115, final rule 3060.21 is changed. Net income is calculated as competitive products revenue less attributable costs less the appropriate share of institutional costs. Proposed rule 3060.10 will also be changed to be consistent with rule 3060.21. The Commission recognizes that this treatment may need to be revised in the future.

#### B. Pro Forma Balance Sheet

The Postal Service does not believe that there is a statutory requirement for a balance sheet and that requiring the report would detract from the goal of transparency.

---

<sup>5</sup> Docket No. RM2007-1, Order No. 43, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007, at 90-92.

<sup>6</sup> See Horngren *et al.*, *Cost Accounting, A Managerial Emphasis*, at 575.

It contends that, while it would be able to produce the report as contemplated in Rule 3060.30, the report would provide no meaningful information, as it is based on mathematical calculations. Additionally, it notes that it is unrealistic to produce a balance sheet based on an enterprise whose “revenues and expenses are derived from statistical estimates and economic costing rather than Generally Accepted Accounting Principles (GAAP).”<sup>8</sup> The Postal Service suggests that if the Commission still requires the production of this report that the title be changed from a “Pro Forma Balance Sheet” to a “Statement of Allocated Assets and Liabilities for Competitive Products.”<sup>9</sup> On reply, the Public Representative points out that “[t]he absence of specific statutory language addressing a balance sheet requirement does not appear to foreclose the Commission from mandating this type of report, given the Commission’s broad oversight authority.”<sup>11</sup> She states that further Commission discussion of the rationale for such a report would be useful.

---

<sup>8</sup> Initial Comments of the United States Postal Service In Response to Order No. 106, October 20, 2008, at 4 (Postal Service Comments).

<sup>9</sup> *Id.* at 5.

<sup>11</sup> Public Representative's Reply Comments, November 3, 2008, at 2.

The need for the report derives from several sections of the PAEA. The PAEA requires that obligations of the Postal Service issued to support competitive products be supported and serviced by the revenues and receipts from the assets related to the provision of competitive products. 39 U.S.C. 2011(e)(1)(B)(i). It also provides that the competitive products enterprise assets be the greater of the assets related to the provision of competitive products or the percentage of competitive products revenue times total assets of the Postal Service. This implies that the Postal Service must determine the assets used in provision of competitive products. 39 U.S.C. 2011(e)(5). Furthermore, it states that one objective of the accounting practices and principles for competitive products is "identifying and valuing the assets and liabilities" associated with providing competitive products. 39 U.S.C. 2011(h)(1)(A)(i)(I).

The Commission recognizes that the Balance Sheet will not be in conformance with GAAP. However, final rules 3060.12 and 3060.13 require the Postal Service to identify any asset or liability account that is used strictly for either competitive or market dominant products. Thus, only assets and liabilities used jointly will be allocated by mathematical formula.<sup>13</sup> As long as the allocations are done on a reasonable basis, such as percentage of revenue, volume, or other cost driver, they should provide some measure of the resources used in providing competitive products. The Commission believes that this will enhance, rather than detract from, transparency. The Postal Service is encouraged to provide the most relevant and meaningful allocations that it can. If it still believes that the information in the report is not representative, the report should be accompanied by a disclaimer, stating in detail why the Postal Service believes this to be the case.

---

<sup>13</sup> The Commission understands that this may be the majority of accounts at the present time. However, this may change if the competitive products enterprise grows substantially. The Postal Service suggests, and the Commission has incorporated into the rules, isolation of assets, obligations, and investments used exclusively for competitive products,

Further, if the Postal Service decides to calculate the assumed Federal income tax using deductions available under the Internal Revenue Code (IRC), such as depreciation, the report will provide a basis for calculating these deductions.

The Postal Service's objection to calling the combined report of assets and liabilities a "Balance Sheet" is that it is not a true balance sheet according to GAAP. A formal balance sheet would contain sections for capital and equity. The Postal Service argues that a reader could be confused by a report that uses the name "Balance Sheet" but does not contain all the information an accountant would expect to find. The Postal Service will be providing a measure of retained earnings in the financial status report filed pursuant to rule 3060.22. Consequently, a measure of equity could be derived since the Postal Service has no shareholders. If the retained earnings and equity were added to the required report, it would closely approximate the data an accountant would expect to find. However, because the Pro Forma Balance Sheet is not in conformance with GAAP, the Commission will, as the Postal Service suggests, change the name of the report to Statement of Allocated Assets and Liabilities for Competitive Products. While the likelihood of misunderstanding or confusion is slight, changing the name of the report will eliminate any such possibility.

### C. Annual Docket

The Public Representative has requested a rule stating that the Commission will initiate a formal docket each year to receive the reports required by the proposed rules and soliciting comment from the public on the reports. The Public Representative included proposed language for a new rule 3060.2 that would implement her proposal.<sup>15</sup>

The Postal Service opposes such a rule as unnecessary. The Postal Service notes that there is no such rule with respect to the Annual Compliance Report, yet the

---

<sup>15</sup> Public Representative's Comments on Proposed Rules, Attachment A, October 20, 2008.

Commission did solicit comments from the public after the FY2007 report was filed and always has the option to do so with respect to Competitive Products Reporting.<sup>16</sup>

The Public Representative's comments appear focused on the assumed Federal income tax aspects of the financial reports, although her proposed language includes all aspects of the competitive products enterprise reporting and review. She states that “an order the Commission is required to issue under proposed rule 3060.42 provides an unstated opportunity for the Commission to seek public input.”<sup>17</sup> The Postal Service’s reply comments seem to view the Public Representative’s proposal as referring exclusively to the competitive product reports.<sup>18</sup> The Postal Service seems to expect the Commission to give notice and opportunity to comment on these reports in the same manner as the Annual Compliance Review (ACR).

Final rule 3060.20(c) requires the data underlying the competitive products enterprise reports to come from the data underlying the ACR. Under final rule 3060.24, these reports will be due (with the exception of the report for FY2008) at the same time as the ACR. Thus, the Commission will be able to incorporate notice of the competitive products reports into the statutorily required notice and opportunity to comment for the ACR.

The Commission agrees with the Public Representative regarding notice and opportunity for comment on the assumed Federal income tax calculation and final rule 3060.42 incorporates language to this effect.

#### D. Due Dates

In its comments the Postal Service identifies an inconsistency with respect to the due date for the first Pro Forma Balance Sheet (renamed Statement of Allocated Assets

---

<sup>16</sup> Reply Comments of the United States Postal Service in Response to Order No. 106, November 3, 2008, at 3 (Postal Service Reply Comments).

<sup>17</sup> Public Representative’s Comments at 4.

<sup>18</sup> Postal Service Reply Comments at 2.

and Liabilities for Competitive Products in the final rules). The due date for the first report in proposed rule 3060.14 is 2011, while it is 2010 in proposed rule 3060.31. The Commission intended that the first Balance Sheet reflect results for FY 2010, and the final rules reflect this intent.

The Postal Service also requests that the Competitive Products Fund Report (CPFR) be due after or concurrently with the filing of the Income Report and the Statement of Allocated Assets and Liabilities for Competitive Products. The Postal Service reasons that the latter reports would provide input for the CPFR and would need to be completed prior to the filing of the CPFR. It therefore requests that the due dates for financial reports be no later than for the CPFR. The Postal Service proposed that the CPFR be due January 15 and that the financial reports be due in late December.

In setting the deadlines in the proposed rules, the Commission had sought to shift some work of the Postal Service away from the period when the Postal Service is preparing its Annual Compliance Report. The PAEA, however, sets the date for filing "the most recent" CPFR at 90 days from the close of a fiscal year.<sup>19</sup> Accordingly, the CPFR and the other reports required by these rules will be due 90 days after the close of the fiscal year, with an extension to January 15, 2009 for all FY 2008 reports except the CPFR. This extension is intended to allow the Postal Service some additional time to prepare the initial reports. If the Postal Service's experience shows that it can produce the CPFR without having to complete the other financial reports, the due date for those reports can be reexamined in a future rulemaking.

#### IV. CALCULATION OF AN ASSUMED FEDERAL INCOME TAX

39 U.S.C. 3634 outlines the basis for calculating an assumed Federal income tax. First, it defines the term "assumed Federal income tax on competitive products

---

<sup>19</sup> See 39 U.S.C. sections 2011(i)(2) and 3652(a).

income” to mean “the net income tax that would be imposed by chapter 1 of the Internal Revenue Code of 1986 on the Postal Service’s assumed taxable income from competitive products for the year[.]” 39 U.S.C. 3634(a)(1). Second, it defines the term “assumed taxable income from competitive products” to mean:

the amount representing what would be the taxable income of a corporation under the Internal Revenue Code of 1986 for the year, if—

(A) the only activities of such corporation were the activities of the Postal Service allocable under section 2011(h) to competitive products; and

(B) the only assets held by such corporation were the assets of the Postal Service allocable under section 2011(h) to such activities.

*Id.* 3634(a)(2).

Finally, it requires the assumed tax be “paid,” *i.e.*, transferred from the Competitive Products Fund to the Postal Service Fund, on or before January 15 of the next subsequent year. *Id.* 3634(b)-(c).

What follows is a discussion of the concepts the Commission believes are pertinent to the substantive and procedural rules governing the assumed Federal income tax for the theoretical competitive products enterprise.

In Order No. 106, the Commission states that a simplified approach to calculating the tax is desirable but must comply with section 3634(a). That is, the method used to compute the tax must be allowable under chapter 1 of the Internal Revenue Code.<sup>20</sup> The Commission summarizes the Treasury’s report on this topic. Treasury endorsed a simplified approach that applied an average effective tax rate for C corporations or the maximum statutory tax rate to the Postal Service’s net book income. It cautioned,

---

<sup>20</sup> Order No. 106 at 23.

however, that this approach “would require some level of PAEA intent interpretation and scope determination by the appropriate governance bodies.” *Id.*

The Postal Service states that the calculation of Federal taxable income and subsequently Federal income tax in accordance with IRC chapter 1 would be administratively onerous and the results may be inaccurate. It advocates using Line 10 “Net Income (Loss) Before Tax” from the Annual Income Report as assumed taxable income and multiplying the unadjusted amount by an effective tax rate, similar to the rate published by the Statistics of Income (SOI) Corporation Report. Postal Service Comments at 8, Attachment 2. It notes that the effective tax rate would include adjustments to taxable income for permanent items and credits of comparable corporations within the broad sector of Transportation and Warehousing. It also notes that the SOI data, though not current, is readily accessible and updated with a time lag. Alternatively, it suggests that the statutory C corporation tax rate could be applied.

The Commission, while recognizing the benefits of a simplified approach, notes that differences between book income and taxable income can arise from either temporary or permanent differences. Temporary differences are the result of differences in the timing of income recognition for book and tax purposes and will eventually reverse over time resulting in no impact to total pretax net income. Permanent differences are due to differences in the definition of income for book and tax purposes. The exclusion of OSHA Fines and Penalties from taxable income but not book income in accordance with 26 U.S.C.162(f) is such an example. Permanent differences have a permanent impact on total pretax net income. Under strict compliance with IRC chapter 1, both permanent and temporary differences must be recognized.

However, given that the assumed income tax is an intra-agency transfer, and has neither attached penalties nor the incentive to shift income between years, the Commission finds that temporary timing differences do not need to be recognized for purposes of calculating the assumed Federal income tax. In contrast, pretax book income should be adjusted for permanent differences. The calculation of taxable

income for competitive products income is: Pretax Net Income as reported on the Annual Income Report less permanent differences related to competitive products. Given the intent of the PAEA to compute taxable income pursuant to IRC chapter 1, the Commission concludes that this alternative approach to computing taxable income is consistent with section 3634 and offers the Postal Service a simplified, cost-effective means for calculating the assumed Federal income tax.

The Commission concurs with Treasury's recommendation of the simplified method of computing the assumed Federal income tax using the highest marginal statutory tax rate, currently set at 35%. The Commission notes that because corporate tax law allows for certain deductions, exclusions, and credits, corporations are unlikely to pay tax at the statutory tax rate. However, the Postal Service also will be allowed under the final rules to avail itself of applicable deductions, exclusions, and credits if it so chooses.

The Postal Service's proposed alternative of applying the SOI tax rate is flawed. First and foremost, the companies identified in the SOI are not representative of the Postal Service. The effective tax rates of the sample corporations may result from unique tax positions, credits, foreign taxes, IRS audit adjustments and historical net operating losses that would not be comparable to the rate applicable to the Postal Service. In fact, the Commission believes that there are very few, if any, C corporations that would be comparable to the Postal Service, given its status as an independent establishment of the executive branch of the United States Government. Secondly, the referenced rates are not current.

The Commission's simplified approach applies the statutory C corporation Federal income tax rate to the competitive products enterprise's pretax net income less permanent differences related to competitive products. See rule 3060.40.

In lieu of simply applying the statutory C corporations' tax rate to the theoretical competitive products enterprise pretax income adjusted for permanent differences, the Postal Service may elect, under the proposed rules, to avail itself of various deductions and/or credits under chapter 1 of the IRC. See rule 3060.40. This option is available to

the extent the Postal Service wishes to use it to reduce the competitive products enterprise's assumed Federal income tax.

The Commission does not want to impose unnecessary burdens on the Postal Service, and it finds that using either of these approaches to calculate the assumed Federal income tax will be neither burdensome nor costly. The complexity of computing the appropriate tax rate and income tax due for the theoretical competitive products enterprise under chapter 1 of the IRC is largely determined by the specific tax treatments the Postal Service chooses to apply. The Postal Service may choose to take any or all appropriate deductions and/or credits; however, the costs of attempting to reduce the transfer payment must be weighed against the benefits.<sup>21</sup>

*Net Operating Loss.* The Public Representative recommends that the mechanics of the Net Operating Loss (NOL) provision be revised to align it closer to IRC chapter 1. The Postal Service agrees, and both parties submitted suggested revisions. The Commission's final rules reflect these suggestions.

The carry back and carry forward provisions of a NOL smooth the disparity in fluctuating incomes caused by the use of an annual accounting period. A carry back of a competitive products NOL resulting in the refund of previously transferred tax remittances to the Postal Service Fund should not be viewed as a prohibited cross-subsidy by market dominant products of competitive products since the refund cannot exceed the tax paid for the prior two years. The competitive products enterprise would not be receiving any funds in excess of what it has paid to the market dominant products. The NOL provision should be viewed as the same type of tax treatment any Postal Service competitor would be permitted to claim under chapter 1 of the IRC.<sup>22</sup> 26 U.S.C. 172.

---

<sup>21</sup> See Docket No. PI2008-2, Reply Comments of the Parcel Shippers Association on Treasury Report, May 1, 2008, at 3, suggesting that any expenditure to reduce the assumed tax payment would represent a net loss to the Postal Service.

<sup>22</sup> The following example is illustrative of the possible use of NOLs for the theoretical competitive products enterprise tax liability computation: In fiscal years 2008 and 2009, the competitive products enterprise earned \$150,000,000 in assumed taxable income and transferred \$52,500,000 (\$150,000,000

*Statute of Limitations.* The Public Representative requests expansion of certain provisions relating to the statute of limitations for addressing errors in the assumed Federal income tax calculation on competitive products. The Commission adopts the 3-year statute of limitations under 26 U.S.C. 6501(a). The Commission is aware that longer statutes of limitations are available under IRC chapter 1. The Commission reasons that there will be only one annual filing, with potentially complicated issues addressed in advance of filing, and as such, it does not see any need to extend the proposed period.

*Investment Income.* Under Section 2011, funds from Competitive Products in excess of current needs may be invested in Treasury obligations, or in any other investment choice with the consent of the Secretary of the Treasury. Income generated from the investment of excess monies from competitive products would be reported as a separate line item on the Income Report and could be netted with the related cost, if any, for the generation of such income. The Public Representative requests clarification of the tax treatment of this income.

Income derived from the investment in corporate stock would be subject to taxation pursuant to 26 U.S.C. 243 and a deduction for dividends received would be allowed. The dividends received deduction (DRD) is generally 70% (but can be 80% or 100% depending on the ownership percentage) of dividends received from U.S. taxable corporations. The 70% and 80% DRD is limited to 70% and 80%, respectively, of taxable income computed without the DRD, net operating loss carryovers, and capital loss carry backs. The limitation is disregarded if a net operating loss results after deducting the general rule DRD.

---

x 35%) in assumed Federal income tax from the Competitive Products Fund to the Postal Service Fund. Then in year 2010 the competitive products enterprise reported a loss of \$60,000,000, resulting in a refund of assumed Federal income taxes transferred in prior years of \$21,000,000 (\$60,000,000 x 35%). The refund resulting from the NOL carry back is appropriate as it would not exceed the total assumed Federal income taxes paid in the prior two years and as such should not be viewed as a cross-subsidy of competitive products by market dominant products. This would be the same tax treatment that would be available to any regular domestic corporation under section 172 of chapter 1 of the Internal Revenue Code.

Income derived from the investment in entities exempt from tax under Section 501 or 521 of the IRC would not be reduced or offset by expenses incurred in the generation of such income, including the dividends received deduction.

## V. SECTION-BY-SECTION ANALYSIS

Below, the Commission provides a concise description of each rule designed to assist readers in understanding the scope and nature of the rules.

*Rule 3060.1 Scope.* This provision sets forth the scope of the Postal Service's obligation with regard to the assumed Federal income tax due on competitive products income. On an annual basis, the Postal Service must calculate the assumed Federal income tax on competitive products income and transfer any tax due from the Competitive Products Fund to the Postal Service Fund.

*Rule 3060.10 Costing.* This rule defines income subject to tax as competitive products revenue minus competitive products costs. Competitive products costs are defined as volume-variable costs plus product-specific costs plus assigned share of institutional costs. All costs are to be calculated using the methodologies most recently approved by the Commission.

*Rule 3060.11 Valuation of Assets.* This rule sets forth the basis for assigning assets to the theoretical competitive products enterprise.

*Rule 3060.12 Asset Allocation.* This rule requires the Postal Service to allocate all assets between competitive and market dominant products within 6 months of the effective date of the rule and to use these allocations to prepare the allocated assets and liabilities report required by rule 3060.30. The Commission must approve the methods of allocation.

*Rule 3060.13 Valuation of Liabilities.* This rule requires the Postal Service to allocate all liabilities between competitive and market dominant products within 6 months of the effective date of the rule and to use these allocations to prepare the

allocated assets and liabilities report required by rule 3060.30. The Commission must approve the methods of allocation.

*Rule 3060.14 Statement of Allocated Assets and Liabilities for Competitive Products.* This rule directs the Postal Service to prepare and submit a Statement of Allocated Assets and Liabilities for Competitive Products no later than 90 days after the close of FY 2010.

*Rule 3060.20 Reports.* This rule sets forth the accounting procedures to be used for reporting on the theoretical competitive products enterprise. It sets the deadline for filing the reports at 90 days after the close of the fiscal year (with the exception of FY 2008); requires that each report include workpapers citing all numbers to primary sources and notes that provide summary descriptions of computations used, assumptions made, and other relevant information; specifies the books of accounts and data collection systems to be used; and requires the Postal Service to use the same accounting practices for future reports as approved by the Commission in its review of the FY 2008 reports, including changes adopted by the Commission. The rule also specifies the procedures which the Postal Service must use for any proposed changes in accounting practices.

*Rule 3060.21 Income Report.* This rule requires the Postal Service to file an income report for the theoretical competitive products enterprise and specifies the form and content of the report.

*Rule 3060.22 Financial Status Report.* This rule requires the Postal Service to file a report showing changes in net income, financial obligations, and financial investments for the theoretical competitive products enterprise and specifies the form and content of the report.

*Rule 3060.23 Identified Property and Equipment Assets Report.* This rule requires the Postal Service to file a report showing net book value for assets devoted to the theoretical competitive products enterprise and specifies the form and content of the report.

*Rule 3060.24 Competitive Products Fund Report.* This rule requires the Postal Service to file with the Commission a copy of the report filed within 90 days of the end of the previous fiscal year with the Secretary of the Treasury pursuant to 39 U.S.C. 2011(i)(1).

*Rule 3060.30 Statement of Allocated Assets and Liabilities for Competitive Products.* This rule requires the Postal Service to file a report showing how total assets and liabilities of the Postal Service are allocated to the theoretical competitive products enterprise and specifies the form and content of the report.

*Rule 3060.31 Initial Filing.* This rule sets the date for filing the first Statement of Allocated Assets and Liabilities at 90 days after the close of FY 2010, two years later than for other reports.

*Rule 3060.40 Calculation of the Assumed Federal Income Tax.* This rule addresses how the assumed Federal income tax must be calculated and discusses the timing of such calculations. The rule states that the assumed Federal income tax on competitive products income must be calculated in compliance with chapter 1 of the IRC. A calculation under chapter 1 of the IRC requires the computation of the competitive products enterprise's assumed tax liability at either the section 11 (regular) or section 55(b)(1)(B) (AMT) tax rates, as applicable. The provision further provides that no estimated Federal income taxes need to be calculated or paid and also states that no state, local, or foreign income taxes need to be calculated or paid.

With regard to the timing of the calculation of the assumed Federal income tax, the rule provides that the end of the fiscal year for the calculation of the tax shall be September 30 (which coincides with the Postal Service's regular fiscal year end). The provision further requires that the assumed Federal income tax must be calculated by January 15 of the following year.

*Rule 3060.41 Supporting Documentation.* This rule specifies the underlying details that the Postal Service must provide to support its calculation of tax liability under rule 3060.40.

*Rule 3060.42 Commission Review.* This rule states that the Commission will solicit public comments on and review the documentation submitted under rule 3060.41 and issue an order on its findings by July 15. The proposed rule also states that the Commission may order the Postal Service to cure or explain any errors, omissions, or other deficiencies discovered within 3 years of a filing pursuant to rule 3060.40.

*Rule 3060.43 One-Time Extension.* This rule allows for a one-time extension of 6 months, until July 15, 2009, for the calculation of the assumed Federal income tax due for the fiscal year ending September 30, 2008.

*Rule 3060.44 Annual Transfer from Competitive Products Fund to the Postal Service Fund.* This rule provides a “payment” method for the assumed Federal income tax due on competitive products’ income. On an annual basis, the Postal Service must transfer the assumed Federal income tax due on competitive products income from the Competitive Products Fund to the Postal Service Fund. As long as a tax is actually due, it must be transferred to the Postal Service Fund no later than January 15 of the year following the close of the fiscal year. As with the calculation in rules 3060.40 and 3060.43, a one-time 6-month extension, until July 15, 2009, is granted for the transfer of the assumed Federal income tax due for fiscal year end September 30, 2008.

Under this rule, if competitive products enterprise’s assumed taxable income for a given fiscal year is negative, the Postal Service is not required to pay a tax for that year, but may be entitled to claim a loss. If a payment was made to the Postal Service Fund in the previous year, the Postal Service may transfer the lesser of (1) the amount paid into the Postal Service Fund in the past 2 years, or (2) the amount of the hypothetical tax on the loss. The hypothetical tax on the loss should be computed as the statutory tax rate multiplied by the amount of the loss. This transfer must also be made no later than January 15 of the year following the end of the fiscal year. If, however, no payment was made into the Postal Service Fund in the previous 2 years, the loss may only be carried forward and offset against any calculated assumed Federal taxable income on competitive products income for the following 20 years.

*It is Ordered:*

1. The Commission hereby adopts final rules on accounting practices and tax rules for Competitive Products for incorporation into the Commission's Rules of Practice and Procedure at 39 CFR 3060.
2. The rules referred to in ordering paragraph 1 will take effect 30 days after publication in the *Federal Register*.
3. The Secretary shall arrange for publication of this Order in the *Federal Register*.

By the Commission.

Steven W. Williams  
Secretary

## VI. FINAL RULES

**PART 3060—ACCOUNTING PRACTICES AND TAX RULES FOR THE THEORETICAL COMPETITIVE PRODUCTS ENTERPRISE****§ 3060.1 Scope**

The rules in this part are applicable to the Postal Service's theoretical competitive products enterprise developed pursuant to 39 U.S.C. 2011 and 3634 and to the Postal Service's obligation to calculate annually an assumed Federal income tax on competitive products income and transfer annually any such assumed Federal income tax due from the Competitive Products Fund to the Postal Service Fund.

**§ 3060.10 Costing**

(a) The assumed taxable income from competitive products for the Postal Service's theoretical competitive products enterprise for a fiscal year shall be based on total revenues generated by competitive products during that year less the costs identified in paragraph (b) calculated using the methodology most recently approved by the Commission.

(b) The net income for the Postal Service's theoretical competitive products enterprise shall reflect the following costs:

(1) Attributable costs, including volume variable and product specific costs; and

(2) The appropriate share of institutional costs assigned to competitive products by the Commission pursuant to 39 U.S.C. 3633(a)(3).

**§ 3060.11 Valuation of Assets**

For the purposes of 39 U.S.C. 2011, the total assets of the Postal Service theoretical competitive products enterprise are the greater of:

(a) The percentage of total Postal Service revenues and receipts from competitive products times the total net assets of the Postal Service, or

(b) The net assets related to the provision of competitive products as determined pursuant to rule 3060.12.

**§ 3060.12 Asset Allocation**

Within 6 months of the effective date of these rules, and for each fiscal year thereafter, the Postal Service will develop the net assets of the theoretical competitive products enterprise as follows:

(a) Identify all asset accounts within the Postal Service's Chart of Accounts used solely for the provision of competitive products.

(b) Identify all asset accounts within the Postal Service's Chart of Accounts used solely for the provision of market dominant products.

(c) The portion of asset accounts in the Postal Service's Chart of Accounts that are not identified in either (a) or (b) above shall be assigned to the Postal Service theoretical competitive products enterprise using a method of allocation based on appropriate revenue or cost drivers approved by the Commission.

(d) Within 6 months of the effective date of these rules, the Postal Service shall submit to the Commission for approval a proposed methodology detailing how each asset account identified in the Chart of Accounts shall be allocated to the theoretical competitive products enterprise and provide an explanation in support of each allocation.

(e) If the Postal Service desires to change the methodologies outlined above, it shall utilize the procedures provided in rule 3050.11.

**§ 3060.13 Valuation of Liabilities**

Within 6 months of the effective date of these rules, and for each fiscal year thereafter, the Postal Service will develop the liabilities of the theoretical competitive products enterprise as follows:

(a) Identify all liability accounts within the Postal Service's Chart of Accounts used solely for the provision of competitive products.

(b) Identify all liability accounts within the Postal Service's Chart of Accounts used solely for the provision of market dominant products.

(c) The portion of liability accounts in the Postal Service's Chart of Accounts that are not identified in either (a) or (b) above shall be assigned to the theoretical competitive products enterprise using a method of allocation based on appropriate revenue or cost drivers approved by the Commission.

(d) Within 6 months of the effective date of these rules, the Postal Service shall submit to the Commission for approval a proposed methodology detailing how each liability account identified in the Chart of Accounts shall be allocated to the theoretical competitive products enterprise and provide an explanation in support of each allocation.

(e) If the Postal Service desires to change the methodologies outlined above, it shall utilize the procedures provided in rule 3050.11.

#### **§ 3060.14 Competitive Products Enterprise Statement of Allocated Assets and Liabilities**

The Postal Service will report the assets and liabilities of the theoretical competitive products enterprise as computed under rules 3060.12 and 3060.13 in the format as prescribed under rule 3060.30 for each fiscal year starting with FY 2010.

#### **§ 3060.20 Reports**

(a) Beginning with reports for FY 2009, the Postal Service shall file with the Commission each of the reports required by this part by no later than 90 days after the close of each fiscal year. For FY 2008, the Postal Service may file these reports by January 15, 2009, with the exception of the report required by 3060.24.

(b) Each report shall include workpapers that cite all numbers to primary sources and such other information needed to present complete and accurate financial information concerning the provision of competitive products.

(c) Each report shall utilize the same books of accounts and data collection systems used to produce the report required by 39 CFR 3050.

(d) Each report shall include summary descriptions of computations used, assumptions made, and other relevant information in the form of notes to the financial statements.

(e) A one-time extension until January 15, 2009, shall be permitted for the submission of the reports due for fiscal year ending September 30, 2008.

(f) The accounting practices used by the Postal Service in the reports filed for FY 2008, as approved by the Commission, shall be used for all future reports until such time as they may be changed by the Commission. If the Postal Service desires to change such practices, it shall utilize the procedures provided in rule 3050.11.

**§ 3060.21 Income Report**

The Postal Service shall file an Income Report in the form and content of Table 1, below.

Table 1 Proposed Competitive Products Income Statement (\$ in 000s)				
	FY 20xx	FY 20xx-1	% Change from SPLY	% Change from SPLY
PRC Form CP-01				
Revenue:	\$x,xxx	\$x,xxx	\$xxx	xx.x
(1) Mail and Services Revenues	xxx	Xxx	xx	xx.x
(2) Investment Income	\$x,xx	\$x,xxx	\$xxx	xx.x
(3) Total Competitive Products Revenue				
Expenses:				
(4) Volume-Variable Costs	\$x,xxx	\$x,xxx	\$xxx	xx.x
(5) Product Specific Costs	x,xxx	x,xxx	xxx	xx.x
(6) Total Competitive Products Attributable Costs	\$x,xxx	\$x,xxx	\$xxx	xx.x
(7) Net Income Before Institutional Cost Contribution	\$x,xxx	\$x,xxx	\$xxx	
(8) Required Institutional Cost Contribution	\$x,xxx	\$x,xxx	\$xxx	x.x
(9) Net Income (Loss) Before Tax	\$x,xxx	\$x,xxx	\$xxx	
(10) Assumed Federal Income Tax	\$x,xxx	\$x,xxx	\$xxx	xx.x
(11) Net Income (Loss) After Tax	\$x,xxx	\$x,xxx	\$xxx	xx.x
Line (1): Total revenues from Competitive Products volumes and Ancillary Services				
Line (2): Income provided from investment of surplus Competitive Products revenues				
Line (3): Sum total of revenues from Competitive Products volumes, services, and investments				
Line (4): Total Competitive Products volume variable costs as shown in the Cost and Revenue Analysis (CRA) report				
Line (5): Total Competitive Products product specific costs as shown in the CRA report				
Line (6): Sum total of Competitive Products costs (sum of lines 4-5)				
Line (7): Difference between Competitive Products total revenues and attributable costs (line 3 less line 6)				
Line (8): Minimum amount of Institutional Cost contribution required under 39 CFR 3015.7 of this chapter.				
Line (9): Line 7 less line 8				
Line (10): Total assumed Federal income tax as calculated under 39 CFR 3060.40				
Line (11): Line 9 less line 10				

**§ 3060.22 Financial Status Report**

The Postal Service shall file a Financial Status Report in the form and content of Table 2, below.

Table 2 Annual Summary of Competitive Products Financials (\$ in 000s)					
PRC Form CP-02					
		Beginning Value	Change from Prior Year	Ending Value	
(1)	Cumulative Net Income (Loss) After Assumed Federal Income Tax				
(2)	Total Financial Obligations (List of Financial Obligations)				
(3)	Total Financial Investments (List of Financial Investments)				
Line 1:	Beginning Value: Sum total of Net Income (Loss) as of October 1 of Reportable Fiscal Year				
	Change from Prior Year: Amount of Net Income (Loss) of Reportable Fiscal Year				
	Ending Value: Sum of Beginning Value and the Change from Prior Year				
Line 2:	Beginning Value: Sum total of Financial Obligations as of October 1 of Reportable Fiscal Year				
	Change from Prior Year: Amount of Net Financial Obligations of Reportable Fiscal Year				
	Ending Value: Sum of Beginning Value and the Change from Prior Year				
Line 3:	Beginning Value: Sum total of Financial Investments as of October 1 of Reportable Fiscal Year				
	Change from Prior Year: Amount of Net Financial Investments of Reportable Fiscal Year				
	Ending Value: Sum of Beginning Value and the Change from Prior Year				

**§ 3060.23 Identified Property and Equipment Assets Report**

The Postal Service shall file an Identified Property and Equipment Assets Report in the form and content of Table 3, below.

Table 3 Competitive Products Property and Equipment Assets (\$ in 000s)						
PRC Form CP-03						
Finance Number	Finance Location	Asset Identifier	Asset Description	Cost	Accumulated Depreciation	Net Book Value
Total				\$x,xxx	\$x,xxx	\$x,xxx

**§ 3060.24 Competitive Products Fund Report**

Within 90 days of the close of each fiscal year the Postal Service will provide the most recent report of the activity of the Competitive Products Fund as provided to the Secretary of the Treasury under 39 U.S.C. 2011(i)(1).

**§ 3060.30 Statement of Allocated Assets and Liabilities for Competitive Products**

(a) The Postal Service shall file a Statement of Allocated Assets and Liabilities for Competitive Products in the form and content of Table 4, below.

Table 4 Statement of Allocated Assets and Liabilities for Competitive Products (\$ in Millions)				
PRC Form CP-04				
	FY20XX		FY 20XX-1	
Total Net Assets	USPS Annual Report	Competitive Products	Competitive Products	Distributed on Basis of:
Cash and Cash Equivalents	\$x,xxx	\$x,xxx	\$x,xxx	
Net Accounts Receivable	x,xxx	x,xxx	x,xxx	
Supplies, Advances, and Prepayments	x,xxx	x,xxx	x,xxx	

Appropriations Receivable— Revenue Forgone	x,xxx	x,xxx	x,xxx	
Total Current Assets	x,xxx	x,xxx	x,xxx	
Property and Equipment:				
Buildings	x,xxx	x,xxx	x,xxx	
Leasehold Improvements	x,xxx	x,xxx	x,xxx	
Equipment	x,xxx	x,xxx	x,xxx	
Land	x,xxx	x,xxx	x,xxx	
Accumulated Depreciation	x,xxx	x,xxx	x,xxx	
Construction in Progress	x,xxx	x,xxx	x,xxx	
Total Property and Equipment, Net	x,xxx	x,xxx	x,xxx	
Total Assets	\$x,xxx	\$x,xxx	\$x,xxx	
Total Assets Determined from Section 2011(e)(5)	\$x,xxx	\$x,xxx	\$x,xxx	
Total Net Liabilities	USPS Annual Report	FY 20XX Competitive Products	FY 20XX-1 Competitive Products	Distributed on Basis of:
Liabilities:				
Current Liabilities:				
Compensation and Benefits	\$x,xxx	\$x,xxx	\$x,xxx	
Payables and Accrued Expenses	x,xxx	x,xxx	x,xxx	
Customer Deposit Accounts	x,xxx	x,xxx	x,xxx	
Deferred Revenue-Prepaid Postage	x,xxx	x,xxx	x,xxx	
Outstanding Postal Money Orders	x,xxx	x,xxx	x,xxx	
Prepaid Box Rent and Other Deferred Revenue	x,xxx	x,xxx	x,xxx	
Debt	x,xxx	x,xxx	x,xxx	
Non-Current Liabilities:	x,xxx	x,xxx	x,xxx	
Workers' Compensation	x,xxx	x,xxx	x,xxx	
Employees Accumulated Leave	x,xxx	x,xxx	x,xxx	
Deferred Appropriation and Other Revenue	x,xxx	x,xxx	x,xxx	
Long-Term Portion of Capital Lease Obligations	x,xxx	x,xxx	x,xxx	
Deferred Gains on Sales of Property	x,xxx	x,xxx	x,xxx	
Contingent Liabilities and Other	x,xxx	x,xxx	x,xxx	
Total Liabilities	\$x,xxx	\$x,xxx	\$x,xxx	

(b) The Statement of Allocated Assets and Liabilities for Competitive Products shall detail the analysis and selection of methods of allocation of total assets and liabilities to the competitive products.

**§ 3060.31 Initial Filing**

The due date for filing the initial Statement of Allocated Assets and Liabilities for Competitive Products is 90 days after the close of FY 2010.

**§ 3060.40 Calculation of the Assumed Federal Income Tax**

(a) The assumed Federal income tax on competitive products income shall be based on the Postal Service theoretical competitive products enterprise income statement for the relevant year and must be calculated in compliance with chapter 1 of the Internal Revenue Code by computing the tax liability on the taxable income from the competitive products of the Postal Service theoretical competitive products enterprise at the section 11 (regular) or section 55(b)(1)(B) (Alternative Minimum Tax) tax rates, as applicable.

(b) The end of the fiscal year for the annual calculation of the assumed Federal income tax on competitive products income shall be September 30.

(c) The calculation of the assumed Federal income tax due shall be submitted to the Commission no later than the January 15 following the close of the fiscal year referenced in paragraph (b), except that a one-time extension of 6 months, until July 15, 2009, shall be permitted for the calculation of the assumed Federal income tax due for fiscal year end September 30, 2008.

(d) No estimated Federal income taxes need to be calculated or paid.

(e) No state, local, or foreign income taxes need to be calculated or paid.

**§ 3060.41 Supporting Documentation**

(a) In support of its calculation of the assumed Federal income tax, the Postal Service shall file detailed schedules reporting the Postal Service theoretical competitive products enterprise assumed taxable income, effective tax rate, and tax due.

(b) Adjustments made to book income, if any, to arrive at the assumed taxable income for any year shall be submitted to the Commission no later than January 15 of the following year.

**§ 3060.42 Commission Review**

(a) Interested persons shall be provided an opportunity to comment on the filing of the calculation of the assumed Federal income tax and supporting documentation.

(b) The Commission will review the calculation of the assumed Federal income tax submitted pursuant to rule 3060.40, the supporting documentation submitted pursuant to rule 3060.41, and any comments. The Commission then will issue an order either approving the calculation of the assumed Federal income tax for that tax year or take such other action as the Commission deems appropriate, including, but not limited to, directing the Postal Service to file additional supporting materials.

(c) The Commission will issue such order no later than 6 months after the Postal Service's filing pursuant to rule 3060.40.

(d) Notwithstanding paragraph (b), if the Commission determines within 3 years of its submission that the Postal Service's calculation of an assumed Federal income tax is incomplete, inaccurate, or otherwise deficient, the Commission will notify the Postal Service in writing and provide it with an opportunity to cure or otherwise explain the deficiency. Upon receipt of the Postal Service's responsive pleading, the Commission may order such action as it deems appropriate.

**§ 3060.43 Annual Transfer from Competitive Products Fund to Postal Service Fund**

(a) The Postal Service must on an annual basis transfer the assumed Federal income tax due on competitive products income from the Competitive Products Fund to the Postal Service Fund.

(b) If the assumed taxable income from competitive products for a given fiscal year is positive, the assumed Federal income tax due, calculated pursuant to rule

3060.40, shall be transferred to the Postal Service Fund no later than the January 15 following the close of the relevant fiscal year.

(c) A one-time extension of 6 months, until July 15, 2009, shall be permitted for the transfer of the assumed Federal income tax due for fiscal year ending September 30, 2008.

(d) If assumed taxable income from competitive products for a given fiscal year is negative, and:

(1) a payment was made to the Postal Service Fund for the previous tax year, a transfer equaling the lesser of the amount paid into the Postal Service Fund for the past 2 tax years or the amount of the hypothetical tax on the loss shall be made from the Postal Service Fund to the Competitive Products Fund no later than the January 15 following the close of the relevant fiscal year; or

(2) no payment has been made into the Postal Service Fund for the previous 2 tax years, the loss may be carried forward and offset against any calculated assumed Federal taxable income on competitive products income for 20 years.