

**August 30, 2005**

**The following document contains Avista Corporation's responses to the questions posed by the Oregon Commission Staff pertaining to Senate Bill 408. The responses have been e-mailed to [puc.sb408@state.or.us](mailto:puc.sb408@state.or.us).**

**Sincerely,**

**David J. Meyer**

**Vice President and Chief Counsel of Regulatory and Governmental Affairs**

August 12, 2005

To Interested Parties:

Senate Bill 408, regarding matching utility taxes paid with taxes collected, has passed both houses and awaits the Governor's signature. Staff will be proposing the Commission adopt temporary rules for the report to be filed by utilities by October 15, 2005. The Commission intends to have temporary rules in place by the middle of September. The Commission has scheduled a Public Meeting to consider and possibly adopt temporary rules for September 14, 2005 at 9:30 a.m. in the Main Hearing Room in the Public Utility Commission Building.

Listed below are several questions that staff would like feedback on from interested parties. In addition, staff would like parties to submit proposed language for temporary rules along with responses to the questions. Because of the tight time-frame, staff is requesting that parties submit responses and proposed temporary rules by **August 30, 2005**. Staff will issue a public meeting memo with its recommendations for temporary rules no later than September 9, 2005.

Please answer the following questions, and explain why, including (where applicable) citations to subsections of SB 408 that support your response. For some of your answers, numerical examples illustrating your meaning may be helpful.

1. In Section 3(1), does "determined without regard to the tax year for which taxes were paid" mean that, for example, 2006 taxes paid equal net cash payments during calendar or fiscal year 2006?

Avista agrees with Staff's interpretation. Taxes paid in 2006 could include amounts related to any tax year.

2. In Section 3(1), what provision should be made for a utility whose fiscal year ends close enough to October 15 that not all the pertinent data is available for the tax report?

Avista suggests that a provision be made that allows fiscal-year taxpayers at least the same 9 ½ months between the end of the fiscal year and when the report is due that is allowed for calendar-year taxpayers. This could be accomplished by allowing reports for fiscal years to be reported on the October 15<sup>th</sup> that occurs no sooner than 9 ½ months subsequent to the end of the fiscal year. Or, an

alternative approach would be to allow for a different report date for fiscal-year taxpayers that is 9 ½ months after the close of their fiscal year.

3. In Section 3(3), what does “directly or indirectly” mean with respect to taxes collected as part of rates?

“Directly” might be interpreted to mean that the taxes are collected through a separate tariff. “Indirectly” might be interpreted to mean that the taxes are collected in general base tariff rates.

4. In Section 3(3), is disclosure limited to a difference based on the entire amount paid by the affiliated group with no attribution to regulated operations? It is reasonable to assume that the amount paid should be the amount attributed to the regulated operations of the utility as defined in Section 3(12)(a) and (b).

5. Do the following phrases all have the same meaning: “amount of taxes authorized to be collected in rates” (3(1) and 3(13)(e)); “amount of costs for taxes collected, directly or indirectly, as part of rates paid by customers” (3(3)); “amount of taxes assumed in rates or otherwise collected from ratepayers” (3(4)); and “taxes that are authorized to be collected through rates” (3(6))?

It is reasonable to assume that the above listed phrases all have the same meaning. “Taxes authorized to be collected in rates” is defined in Section 3(13)(e). An option is to collect taxes under a separate tariff in order to accurately determine the amount of actual taxes collected. Section 3(13)(e) appears to assume that an increase in revenue results in a corresponding increase in taxes collected. This is not the case. Revenues are periodically increased or decreased to reflect changes in the cost of gas. Such purchased gas cost revenue changes do not result in different amounts of income taxes being collected in rates. The same would also apply to the recovery of electric power costs. Changes in kWh or therm sales would be a more accurate determination of changes in taxes collected. Hence, a separate tariff or a specific exclusion of revenues related to the cost of purchased gas or electric power costs should be considered.

6. In Section 3(6), how should “properly attributed to the regulated operations of the utility” be defined and calculated?

Section 3(12)(a) and (b) defines taxes paid that are “properly attributed to the regulated operations of the utility” as the lesser of taxes paid as the result of income generated by the regulated operations of the utility; or taxes paid by the affiliated group. Avista represents that for Avista these two amounts are one in the same for Oregon state income tax. In computing the state tax return an apportionment percentage is applied to determine income generated from Oregon utility operations. Taxes are paid on the apportioned amount. Net income determined in the rate setting process should not be used to set the amount of state income taxes collected from customers. Taxes paid should be the amount that is authorized to be collected in rates.

7. In Section 3(7), how should “properly attributed to any unregulated affiliate” be defined and calculated?

Avista’s only income being generated in Oregon is from utility operations. The apportionment percentage method is used by the Oregon State Department of Revenue to determine Oregon taxable income attributable to Avista’s Oregon utility operations. Taxes are paid based on income determined by applying the apportionment percentage. The Department of Revenue uses the apportionment percentage method much like the PUC uses its method of directly assigned and apportioned revenues and expenses to determine net income for rate setting purposes. The apportionment used by the Oregon State Department of Revenue can’t be picked apart to determine which portion of income might relate to out-of-state affiliate or out-of-state utility operations.

8. In Section 3(9), does the use of the term “establishing” mean that any determination of material adverse impact should be made when the Commission considers requiring a utility to set up an automatic adjustment clause?

(Note: Staff has indicated that this question need not be responded to at this time)

9. In Section 3(12)(a), how should “portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility” be defined and calculated? Also explain how this section works in combination with 3(12)(b).

As previously explained, the apportionment method used by the Oregon State Department of Revenue determines the amount of taxable income attributable to a utility’s Oregon operations. As is the case with Avista, when the only income produced in Oregon comes from a utility’s utility operations in Oregon, the amount determined using the apportionment method is all related to Oregon utility operations. And, since the amount of taxes paid to the Oregon Department of Revenue is based on the income determined using the apportionment factor, the amounts defined in Section 3(12)(a) and 3(12)(b) are the same.

The above explanation pertains to Oregon state income tax. Federal income taxes can be broken down to determine the amount of taxable income generated by Oregon utility operations. Avista does not know how to allocate income or loss from affiliates to its Oregon utility operations to determine the “lesser of” amounts required be calculated under Section 3(12)(a) and 3(12)(b). Taxes paid would only be less as a result of tax losses from affiliates. Hence, the “lesser of” calculation would only have to be made in the instance that the combined taxable incomes of all affiliates resulted in a net, affiliate-related, tax loss. In that instance, some method would have to be determined to allocate the net, affiliate-related, tax loss to Oregon utility operations.

10. Assume that an automatic adjustment clause is established. Show each step of the calculation required by, in particular, Sections 3(6), 3(12) and 3(13), identifying all information that must be available in the tax report to perform the calculation.

(Note: Staff has indicated that this question need not be responded to at this time)

Avista does not have sufficient time to respond to this request by the requested August 30, 2005 deadline. Avista believes that an extension of time is necessary in order for the Commission to develop temporary rules. Avista also suggests that the development of any rulemaking be suspended until the legality of Senate Bill 408 is determined. Section (4)(2) states that if an automatic adjustment clause is established that the clause shall only apply to taxes paid on and after January 1, 2006. Temporary rules related to the report due October 15, 2005 could simply require that utilities submit copies of their tax returns.

11. Assume the following tax data for three different utilities and their affiliates for a particular year:

	<u>Utility A</u>	<u>Utility B</u>	<u>Utility C</u>
Regulated Utility Operations (tax liability)	130	130	130
Affiliate X (tax liability)	130	65	-20
Affiliate Y (tax liability)	<u>-60</u>	<u>-95</u>	<u>-60</u>
Tax Payment to Governments	200	100	50

For each utility, what is the amount of:

- (a) "taxes paid. . .that are properly attributed to regulated operations of the utility" under Section 3(6); and
- (b) "portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility" under Section 3(12)(a)?  
 (Assume no adjustments are required under Section 3(13)(f).)

As previously explained, due to the apportionment method used by the Oregon Department of Revenue, if the affiliate operations are outside the State of Oregon, then state income taxes are entirely attributed to the utility's Oregon utility operations. If the utility has affiliate operations within the State of Oregon, then the taxes would have to be split somehow between utility and affiliate operations within the state.

As previously explained, in the case of federal income tax, taxes paid would only be less as a result of tax losses from affiliates. Hence, the "lesser of" calculation would only have to be made in the instance that the combined taxable incomes of all affiliates resulted in a net, affiliate-related, tax loss. In that instance, some method would have to be determined to allocate the net, affiliate-related, tax loss to Oregon utility operations. Avista does not have a suggestion on how to make such an allocation.

12. Should adjustments to rates under the automatic adjustment clause be prospective (an estimate for the next year)' retroactive (a "true up" based on actual known results), or both?

Section (4)(2) states that if an automatic adjustment clause is established that the clause shall only apply to taxes paid on and after January 1, 2006. Avista's interpretation is that 2006 taxes paid would be reported by October 15, 2007 and that a rate adjustment could only occur after the Commission's review of that filing. Avista does not believe that a rate adjustment should be based on an estimate of taxes paid, even if there is an eventual true-up to actual taxes paid.

13. If the automatic adjustment clause includes a retroactive true-up feature, does that require authorization under ORS 757.259?

(Note: Staff has indicated that this question need not be responded to at this time)

14. If the automatic adjustment clause includes a deferred or balancing account, at what date are amounts added to the account? Does the account accrue interest, and if so, from what point in time?

(Note: Staff has indicated that this question need not be responded to at this time)

15. In Section 3(13)(d)(A), does income in "federal, state or local tax or fee that is imposed on or measured by income" mean (a) gross income; (b) net income; (c) revenues/receipts, gross or net; or (d) all of the above? Also, provide a list of taxes and fees that would be subject to the legislation.

Avista's interpretation is that income means net income, since net income could be impacted by losses of affiliates and gross income or revenue could not. Avista believes that federal income tax and Oregon state income tax are the only taxes subject to the legislation.

16. What is the definition of "revenues the utility collects from ratepayers in Oregon" in Section 3(13)(e)(A)? Does it include sales for resale?

Only revenue from ratepayers that would receive a tax-related rate adjustment should be included under the definition of revenue collected from ratepayers.

Avista does not believe that sales for resale is to be included in revenue collected from ratepayers as sales for resale customers would not receive a tax-related rate adjustment.

17. What is the definition of "effective tax rate" in Section 3(13)(e)(C)?

The effective tax rate is defined in the section referred to above as being determined by the Commission in establishing rates. Normally, a general rate case establishes rates that include the recovery of income taxes. The effective tax rate is normally calculated by dividing income tax expense by net income before income tax expense. In utility ratemaking net income is usually adjusted to reflect tax depreciation expense rather than book depreciation expense and is also usually adjusted to reflect debt interest expense associated with the debt component of the overall rate of return on rate base.

18. How should local income taxes, which are collected as a line item in the bill rather than in a utility's base rates, be considered under Section 3(13)(e)? Avista is not subject to any local income taxes in Oregon.

19. For the adjustments to taxes paid described in 3(13)(f), what tax rate (e.g., statutory, effective) should be used to calculate the "tax savings?" This section describes adjustments for tax savings associated with charitable contributions and tax credits resulting from investment in the regulated operations of the utility. In the case of charitable contributions, the tax savings would be determined by using the statutory tax rate. In the case of tax credits, the tax credit may be a specific dollar amount, as is the case with investment tax credits, or may be determined by applying the statutory tax rate, depending on the type of tax credit.

20. Does "charitable contributions made by the utility" in Section 3(13)(f)(A) require any allocation between the regulated operations of the utility, and the unregulated operations of the utility? If so, on what basis would the allocation be done?

Avista does not have a definitive response to this question. The basic premise to cost of service is to directly assign costs when you can and allocate costs when you can't directly assign them. Some local contributions could be directly assigned. Other contributions that are more general in nature would have to be allocated. One possible allocation method could be the apportionment factor used by the Oregon Department of Revenue.

21. Does "tax savings realized as a result of tax credits associated with investment by the utility" in Section 3(13)(f)(B) mean only direct tax credits, or alternatively, any tax savings (deductions) related to investment that is new, previously disallowed, or otherwise not included in the utility's most recent general rate case?

Normally, tax credits and tax savings associated with tax credits mean something different than tax savings that result from normal deductions. There is a fairness issue if a new major plant addition was not yet being included in base rates, but the tax savings (aside from the normalization provisions of the legislation) from tax deductions associated with the plant addition were required to be passed-on to customers. In such an instance, the tax savings should not be passed-on to customers.

22. How much time should the Commission use under Section 3(4) to “make the determinations described in this section” and “require the utility to establish an automatic adjustment clause,” respectively?

(Note: Staff has indicated that this question need not be responded to at this time)

23. If you wish, provide comments on any questions or other sections of the bill that you believe the Commission needs to consider in its temporary rulemaking.

No additional comments provided.

24. If you wish, provide proposed temporary rules that address information that should be provided in the tax report and how the automatic adjustment clause should be calculated.

Proposed temporary rules have not been provided. Specific issues that should be addressed in the temporary rules are contained in the responses to the above listed questions.

Please send e-mailed responses to [puc.sb408@state.or.us](mailto:puc.sb408@state.or.us). This mail box will not be activated until August 16, 2005. If you wish to send hard copy responses they should be directed to me. This letter and all responses will be posted to the Commission web site.

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