



CITY OF  
**PORTLAND, OREGON**  
OFFICE OF CITY ATTORNEY

**Linda Meng, City Attorney**  
1221 S.W. 4th Avenue, Suite 430  
Portland, Oregon 97204  
Telephone: (503) 823-4047  
Fax No.: (503) 823-3089

August 21, 2006

**BY E-MAIL AND FIRST CLASS MAIL**

Oregon Public Utility Commission  
Filing Center  
PO Box 2148  
Salem OR 97308-2148

Re: **AR 499** – In the Matter of the Adoption of Permanent Rules to Implement  
SB 408, Relating to Matching Utility Taxes Paid with Taxes Collected

Dear Filing Center:

Enclosed for filing on behalf of the City of Portland is an original and one copy of the City of Portland's Supplemental Filing. Copies have been served to those listed on the attached Service List by e-mail.

Very truly yours,

Benjamin Walters  
Senior Deputy City Attorney

Enclosures

cc: Service List for Docket AR 499

BEFORE THE PUBLIC UTILITY COMMISSION  
OF OREGON

AR 499

In the Matter of the Adoption of Permanent	)	CITY OF PORTLAND’S
Rules Implementing SB 408 Relating to Utility	)	SUPPLEMENTAL FILING
Taxes.	)	
	)	
	)	

---

The City of Portland, Oregon respectfully submits the attached excerpted Chapter 6 of the “Report on the Results of Operations” prepared by the California Public Utilities Commission, Division of Ratepayer Advocates (June 16, 2006) discussing various tax policies of the California PUC. A copy of the full report is available at the following link:  
[http://www.dra.ca.gov/docs/electric/PacifiCorp/A0511022\\_ReportOnResultsOfOperations.pdf](http://www.dra.ca.gov/docs/electric/PacifiCorp/A0511022_ReportOnResultsOfOperations.pdf)  
(site visited August 16, 2006).

The City of Portland submits supplemental information as edifying as to how other regulatory commissions are approaching the issues of normalization, flow through of deferred tax benefits to ratepayers and mandatory tax minimization.

The City of Portland respectfully requests that the attached materials be included in the record for this rulemaking.

Dated this 21<sup>st</sup> day of August, 2006.

Respectfully submitted,

/s/ Benjamin Walters

Benjamin Walters, OSB #85354  
Senior Deputy City Attorney  
Of Attorneys for City of Portland

## CERTIFICATE OF SERVICE

**I HEREBY CERTIFY** that I served the City of Portland's Supplemental Filing in Docket AR 499, upon the following persons on the 21<sup>st</sup> day of August, 2006, by email.

JIM ANDERSON JD ANDERSON ASSOCIATES 910 SAHALEE CT SE SALEM OR 97306	GARY BAUER NORTHWEST NATURAL 220 NW 2ND AVE PORTLAND OR 97209
LAURA BEANE PACIFICORP 825 MULTNOMAH STE 2000 PORTLAND OR 97232	SCOTT BOLTON PACIFICORP 825 NE MULTNOMAH PORTLAND OR 97232
JULIE BRANDIS ASSOCIATED OREGON INDUSTRIES 1149 COURT ST NE SALEM OR 97301-4030	LOWREY R BROWN CITIZENS' UTILITY BOARD OF OREGON 610 SW BROADWAY - STE 308 PORTLAND OR 97205
ED BUSCH PUBLIC UTILITY COMMISSION OF OREGON PO BOX 2148 SALEM OR 97308-2148	REP TOM BUTLER H-289 STATE CAPITOL SALEM OR 97310
RANDALL DAHLGREN PORTLAND GENERAL ELECTRIC 121 SW SALMON ST. 1WTC 0702 PORTLAND OR 97204	MELINDA J DAVISON DAVISON VAN CLEVE PC 333 SW TAYLOR - STE 400 PORTLAND OR 97204
JIM DEASON ATTORNEY AT LAW 521 SW CLAY ST STE 107 PORTLAND OR 97201-5407	MICHAEL EARLY INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES 333 SW TAYLOR STE 400 PORTLAND OR 97204
JASON EISDORFER CITIZENS' UTILITY BOARD OF OREGON 610 SW BROADWAY STE 308 PORTLAND OR 97205	STEVE EVANS MIDAMERICAN ENGERY HOLDINGS COMPANY 666 GRAND AVE DES MOINES IA 50303
EDWARD A FINKLEA CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP 1001 SW 5TH - STE 2000 PORTLAND OR 97204	ANN L FISHER AF LEGAL & CONSULTING SERVICES 2005 SW 71ST AVE PORTLAND OR 97225-3705
ANDREA FOGUE LEAGUE OF OREGON CITIES PO BOX 928 SALEM OR 97308	KELLY FRANCONI ENERGY STRATEGIES 215 SOUTH STATE ST - STE 200 SALT LAKE CITY UT 84111

PAUL GRAHAM DEPARTMENT OF JUSTICE REGULATED UTILITY & BUSINESS SECTION 1162 COURT ST NE SALEM OR 97301-4096	ROBERT JENKS CITIZENS' UTILITY BOARD OF OREGON 610 SW BROADWAY STE 308 PORTLAND OR 97205
JUDY JOHNSON PUBLIC UTILITY COMMISSION PO BOX 2148 SALEM OR 97308-2148	JASON W JONES DEPARTMENT OF JUSTICE REGULATED UTILITY & BUSINESS SECTION 1162 COURT ST NE SALEM OR 97301-4096
GREGG KANTOR NORTHWEST NATURAL 220 NW SECOND PORTLAND OR 97209	MARGARET D KIRKPATRICK NORTHWEST NATURAL 220 NW 2ND AVE PORTLAND OR 97209
ELISA M LARSON NORTHWEST NATURAL 220 NW 2ND AVE PORTLAND OR 97209	PAMELA G LESH PORTLAND GENERAL ELECTRIC 121 SW SALMON ST 1 WTC 1703 PORTLAND OR 97204
KEN LEWIS PO BOX 29140 PORTLAND OR 97296	RAUL MADARANG PORTLAND GENERAL ELECTRIC 121 SW SALMON ST PORTLAND OR 97204
LARRY O MARTIN PACIFIC POWER & LIGHT 825 NE MULTNOMAH STE 800 PORTLAND OR 97232	DENNIS J MAURER DEPARTMENT OF REVENUE
KATHERINE A MCDOWELL MCDOWELL & ASSOCIATES PC 520 SW SIXTH AVE - SUITE 830 PORTLAND OR 97204	DANIEL W MEEK ATTORNEY AT LAW 10949 SW 4TH AVE PORTLAND OR 97219
SENATOR RICK METSGER STATE CAPITOL 900 COURT ST NE S-307 SALEM OR 97301	ALEX MILLER NORTHWEST NATURAL GAS COMPANY 220 NW SECOND AVE PORTLAND OR 97209-3991
JAN MITCHELL PACIFIC POWER & LIGHT 825 NE MULTNOMAH - STE 2000 PORTLAND OR 97232	MARK NELSON PUBLIC AFFAIRS COUNSEL PO BOX 12945 SALEM OR 97309
RICHARD PEACH PACIFICORP 825 NE MULTNOMAH PORTLAND OR 97232	MATTHEW W PERKINS DAVISON VAN CLEVE PC 333 SW TAYLOR - STE 400 PORTLAND OR 97204

DAN PFEIFFER IDAHO PUBLIC UTILITY COMMISSION 472 WEST WASHINGTON ST BOISE ID 83720	PAULA E PYRON NORTHWEST INDUSTRIAL GAS USERS 4113 WOLF BERRY COURT LAKE OSWEGO OR 97035-1827
LISA F RACKNER ATER WYNNE LLP 222 SW COLUMBIA ST STE 1800 PORTLAND OR 97201-6618	PORTLAND GENERAL ELECTRIC CO. RATES & REGULATORY AFFAIRS PORTLAND GENERAL ELECTRIC COMPANY 121 SW SALMON ST 1WTC0702 PORTLAND OR 97204
DAVE ROBERTSON PORTLAND GENERAL ELECTRIC 121 SW SALMON ST PORTLAND OR 97204	AUSEY H ROBNETT III PAINE HAMBLIN COFFIN BROOKE & MILLER PO BOX E COEUR D'ALENE ID 83816-0328
INARA K SCOTT PORTLAND GENERAL ELECTRIC 121 SW SALMON ST PORTLAND OR 97204	BOB TAMLYN PORTLAND GENERAL ELECTRIC 121 SW SALMON ST PORTLAND OR 97204
DOUGLAS C TINGEY PORTLAND GENERAL ELECTRIC 121 SW SALMON 1WTC13 PORTLAND OR 97204	JAY TINKER PORTLAND GENERAL ELECTRIC 121 SW SALMON ST 1WTC-0702 PORTLAND OR 97204
RICK TUNNING MIDAMERICAN ENERGY HOLDINGS CO 666 GRAND AVENUE DES MOINES IA 50303	SENATOR VICKI L WALKER STATE CAPITOL 900 COURT ST NE S-210 SALEM OR 97301
BENJAMIN WALTERS CITY OF PORTLAND OFFICE OF CITY ATTORNEY 1221 SW 4TH AVE - RM 430 PORTLAND OR 97204	LINDA K WILLIAMS KAFOURY & MCDUGAL 10266 SW LANCASTER RD PORTLAND OR 97219-6305
MARCUS A WOOD STOEL RIVES LLP 900 SW FIFTH AVE - STE 2600 PORTLAND OR 97204	PAUL M WRIGLEY PACIFIC POWER & LIGHT 825 NE MULTNOMAH STE 800 PORTLAND OR 97232

/s/ Benjamin Walters

Benjamin Walters, Deputy City Attorney  
City of Portland, Oregon

Application	:	<u>A.05-11-022</u>
Exhibit Number	:	<u>                    </u>
Commissioner	:	<u>Brown</u>
Admin. Law Judges	:	<u>Galvin</u>
Witnesses	:	<u>Various</u>



**DIVISION OF RATEPAYER ADVOCATES  
CALIFORNIA PUBLIC UTILITIES COMMISSION**

**Report on the Results of Operations**

**for  
PacifiCorp**

**General Rate Case  
Test Year 2007**

San Francisco, California  
June 16, 2006

## CHAPTER 6

### TAXES: INCOME, PROPERTY AND PAYROLL

#### I. INTRODUCTION

This chapter presents DRA's analysis and recommendations relating to tax expense. Tax expense is the composite of projected taxable income streams, booked expenses, special tax deductions, and tax credits, calculated within the combined contexts of "real world" tax law and "regulatory world" tax policy. Tax expense also includes taxes which are a function of the payment of employee compensation, and the ownership of plant and property.

DRA and PacifiCorp generally do not differ on any methodologies employed to forecast tax expense. Differences in total estimated taxes are largely due to differences in related inputs. DRA examined PacifiCorp's methodologies, workpapers and supporting workpapers, as well as responses to data requests. DRA also reviewed a number of specific Schedule M adjustments affecting the derivation of regulated taxable income. Schedule M adjustments are individual additions to, and subtractions from operating income in order to account for the various differences between how certain expense and income items are treated for book and tax purposes. Schedule M adjustments account for both permanent and temporary differences.

Regulated tax expense is comprised of the following items: (1) federal income taxes (FIT), and California Corporate Franchise Taxes (CCFT), (2) payroll taxes, and (3) ad valorem, or property taxes.

#### II. SUMMARY/RECOMMENDATIONS

DRA recommends that test year tax expense be computed using the following parameters and assumptions:

1. For federal income tax purposes, the corporate tax rate of 35% should be used to compute FIT. This rate should be used for the net-to gross multiplier. PacifiCorp used the same FIT rate.
2. For state income tax purposes, the California statutory rate of 8.84% should be used to compute CCFT. However, the Unitary effective tax rate of 4.54% should be used to in computing the net-to-gross multiplier. PacifiCorp used the same rates.

3. A Renewable Energy Tax Credit of \$2 million should be used to reduce FIT in the test year. PacifiCorp included the credit in its estimate of regulated FIT.

4. Payroll tax rates and wage bases forecasted by PacifiCorp were found to be reasonable and should be applied in estimating payroll tax expense. Any differences between DRA and PacifiCorp are due to differences in the test year estimate for labor expense.

5. Property tax expense and underlying forecasted valuations were found to be reasonable and should be applied in estimating property taxes. Any differences between PacifiCorp and DRA are due to differences in the test year estimated plant additions.

6. All federal and state tax timing differences should be flowed through to the ratepayer to the extent allowed by Commission policy, and federal and state tax law.

7. DRA recommends that the tax effects stemming from the American Jobs Creation Act of 2004 be included in the test year tax estimates. Specifically, DRA recommends that PacifiCorp's estimate of its Code Section 199 production activity deduction be included in the federal deduction tables. This amount is \$2.3 million and should be flowed through to ratepayers. Any revisions to this estimate should be included in the final showing in this case, prior to the close of the record. Further, tax amortization of Pollution Control Facilities and tax depreciation for qualifying Transmission Assets should be included as tax deductions in arriving at regulated taxable income. PacifiCorp included these additional tax benefits stemming from the aforementioned tax Act.

8. DRA recommends that any changes in federal and state tax laws made before the close of the record in this proceeding be incorporated into the tax estimates for the test year, after review of the new law(s) by DRA.

### **III. DISCUSSION/ANALYSIS**

The following section provides a brief background of regulated tax expense and a discussion of certain specific tax deductions, credits and other tax policy issues applied in determining taxable income for ratemaking purposes, as well as other issues affecting revenue requirements for taxes other than income. Unless otherwise noted, all discussions apply equally to both federal and state tax expense.

#### **Basis for Regulated Tax Expense**

While the mathematical model used to calculate tax expense is seemingly unequivocal, the underlying accounting conventions, applicable tax rates, and the determination of what constitutes allowable deductions is a function of current federal and state tax law, including new laws expected to affect the test year, regulatory tax policy as determined by numerous Commission decisions, and DRA recommended tax and adopted tax policy. Much of existing Commission tax policy was established in Order Instituting Investigation 24 (OII 24), D.84-05-036, 15 CPUC 2d 42 (1984).



1 Numerous subsequent decisions adopted a variety of changes in ratemaking tax policy in  
2 order to comply with changes in federal and state tax laws.

3 The goal of DRA is to minimize tax expense, therefore, minimize revenue  
4 requirements for taxes. Another way to articulate DRA's goal is that the test year's  
5 income tax expense estimate should reflect, to the extent possible, the current deduction  
6 of expenses in which there is a book/tax timing difference. In D.84-05-036, the  
7 Commission stated, "[f]or the present, we will continue our current policy regarding  
8 flow-through treatment of timing differences consistent with applicable tax law."<sup>1</sup> DRA  
9 recommends that the Commission continue to adopt policies which result in the test year  
10 tax estimate reflecting, to the extent possible,<sup>2</sup> the flow-through of forecasted  
11 expenditures. It is important to note that in most cases, it is the regulated utility's *parent*  
12 *corporation*, which actually pays the income taxes of the regulated utility as part of a  
13 consolidated or combined income tax return. Therefore, it is DRA's position that the  
14 regulatory goal of estimating tax expense is to mirror, to the extent permissible by tax  
15 law, the actual tax liability of the regulated unit payable to the parent corporation.

16 The estimated total taxes owed in the test year are an approximation of what will  
17 be PacifiCorp's share of taxes owed by the entire consolidated group. Whether  
18 PacifiCorp actually remits to the parent its share of taxes owed is always a legitimate  
19 question for the regulator. Typically, a utility is part of a combined group of corporations  
20 which files a consolidated income tax return with the Internal Revenue Service as well as  
21 files returns with the appropriate state agency (such as the California Franchise Tax  
22 Board). PacifiCorp is a multi-state corporation; it is part of a consolidated group of  
23 corporations, and files a Unitary tax return with the State of California.

---

<sup>1</sup> See D.84-05-036, discussion at Section I, pgs. 32-33a. The Commission refused to adopt additional normalization requirements beyond those required for depreciation.

<sup>2</sup> DRA's ability to flow-through certain tax deductions and benefits is limited by Income Tax Normalization requirements of the Internal Revenue Code, as well as tax policy established in D.84-05-036. For example, currently, DRA cannot use disallowed expenses as tax deductions.

1     **State Income Tax Rate**

2             For those utilities with operations within and outside California, DRA's policy is  
3     to analyze and consider the allocation procedure under the Unitary tax method.  
4     Application of the Unitary method results in a CCFT rate, which is lower than the  
5     statutory rate. For California State income tax purposes, PacifiCorp's actual tax liability  
6     is not solely dependent on its California operations. PacifiCorp's CCFT must be  
7     determined with reference to a combined report of its entire utility operations. In other  
8     words, PacifiCorp's actual CCFT tax return is filed under the Uniform Division of  
9     Income for Tax Purposes (Unitary) Method.

10            Under this Unitary method, income derived from the conduct of a corporation's  
11    business from sources within and without the state of California is *apportioned* to  
12    California under a three-factor formula set forth in the Uniform Division of Income for  
13    Tax Purposes Act. The combined report applies this formula, which determines the  
14    relationship of California revenues, wages and average net tangible property of all of  
15    PacifiCorp's operations in California to the same three factors for the total of  
16    PacifiCorp's utility system. Using the three-factor apportionment formula may result in a  
17    corporation's effective state income tax rate for ratemaking purposes being lower than the  
18    statutory tax rate within any one state. Since multi-state corporations' California tax  
19    returns include deductions from out of state operations, their effective CCFT tax rate can  
20    be less than the statutory rate.

21            DRA recommends at this time that the statutory rate of 8.84% be used to compute  
22    CCFT on the basis that PacifiCorp has included only California operating revenues in its  
23    tax forecast for California ratemaking purposes. PacifiCorp used a lower effective tax  
24    rate of 4.54% in estimating its net-to-gross multiplier (discussed below) for the test year  
25    2007. Its Unitary methodology is rational, and yields a reasonable result. DRA concurs  
26    with the estimated rate of 4.54%.

27     **Incremental California Franchise Tax Rate; Net-to-Gross Multiplier**

28            DRA recommends PacifiCorp's effective CCFT rate be used to develop the net-to-  
29    gross multiplier. The net-to-gross multiplier is an integral part of the summary of  
30    earnings and is used to determine the gross revenues that a utility requires to receive in

1 order to recover certain costs, which are a function of revenues. Since the focus of the  
2 net-to-gross multiplier is on the increment in revenues needed to receive a specified  
3 addition (or decrease) to net revenues, the effective tax rate on that increment, and not the  
4 statutory CCFT rate, is the appropriate rate to incorporate into the net-to-gross multiplier.  
5 Using the effective CCFT tax rate produces a lower net-to-gross multiplier, therefore, a  
6 lower net marginal increase in revenue requirements.

7 The application of an incremental CCFT tax rate lower than the statutory rate is  
8 consistent with Commission policy set forth in D.84-05-036. Further, applying the  
9 effective CCFT rate may yield a revenue requirement for tax expense, which more  
10 closely approximates the real world CCFT liability of a regulated utility. PacifiCorp used  
11 an effective CCFT rate of 4.54% to calculate the net-to-gross multiplier. DRA concurs  
12 with this rate.

### 13 **Tax Normalization**

14 Normalization is a ratemaking concept, which aims to adjust a utility's operating  
15 expenses in the test year by eliminating abnormal, non-annual events that are known and  
16 certain to change in a regularly recurring manner. For example, accelerated depreciation  
17 is a tax expense, which is normalized over the life of an asset when computing  
18 ratemaking tax expense. It is known and certain that toward the end of the life of an  
19 asset, straight-line (book) depreciation will exceed accelerated tax depreciation.  
20 However, at the conclusion of the asset's life, the total depreciation charges under both  
21 book and tax methods will be equivalent.

22 Income tax normalization permits a utility to include in its current ratemaking  
23 expense, an amount of income tax expense that is higher than what the utility will  
24 actually pay. This is based on the theory that the taxes saved by the accelerated  
25 depreciation (taken on the real world tax returns) are merely deferred. Utilities generally  
26 use accelerated methods of depreciation on their real world tax returns, while using the  
27 straight-line method for book purposes. IRS rules require that utilities use book  
28 depreciation rates on all plant purchased or constructed after 1980 when computing  
29 regulated tax expense. To mitigate the effect of normalization, the tax effect of the

1 differences between accelerated and straight-line depreciation is booked to a deferred tax  
2 reserve. The deferred taxes are used to reduce rate base.

3 There cannot be a “violation” of normalization if the tax attribute alleged to be  
4 “violated” is not subject to normalization under the federal statute. For example, the  
5 adoption of the Unitary tax method for estimating CCFT is not a normalization  
6 “violation” because the Internal Revenue Code (IRC) does not preclude its use by  
7 regulatory agencies as a condition for the utilities to claim tax accelerated depreciation  
8 deductions.

9 Because of current tax law, DRA and utilities are required to adopt normalization  
10 for depreciation on assets placed in service after 1980.<sup>3</sup> However, there is no federal tax  
11 requirement that normalization be used for other tax timing differences. In fact, it is the  
12 policy of this Commission to flow through non-plant tax timing differences.

### 13 **Tax Depreciation/Deferred Taxes**

14 For regulated income taxes purposes, PacifiCorp normalizes the tax effects of  
15 accelerated depreciation for assets placed in service after 1969. For FIT purposes, the tax  
16 depreciation deduction reflects the effect of normalization (discussed above) of federal  
17 tax return depreciation after 1969. Depreciation for pre-1970 vintage plant years  
18 continues to be deducted on a flow-through basis. For CCFT purposes, the tax  
19 depreciation deduction has been computed on a flow-through basis. Tax normalization  
20 results in smaller depreciation deductions otherwise allowable on PacifiCorp’s actual tax  
21 return. To mitigate this effect, the deferred taxes created by tax normalization of tax  
22 depreciation have been included as a reduction from rate base.

### 23 **Interest Expense**

24 For FIT and CCFT purposes, interest expense was derived by applying the  
25 weighted average cost of long-term debt to DRA’s estimated rate base. Differences in  
26 the total amount of interest expense deductible for regulated income tax purposes are,  
27 therefore, the result of differing rate base estimates between PacifiCorp and DRA. The

---

<sup>3</sup> PacifiCorp normalizes the tax benefits of accelerated depreciation for assets placed in service after 1969.

1 unamortized deferred investment tax credit (ITC, discussed below) balance was deducted  
2 from rate base for this calculation because PacifiCorp is an option one company (see  
3 discussion for ITC). "Interest synchronization" which normally results in a higher  
4 interest deduction, and therefore, a lower regulated FIT expense, is not applicable  
5 because of how PacifiCorp treats unamortized ITC (option one). PacifiCorp also used  
6 this approach in its results of operations. For CCFT purposes, the unamortized ITC was  
7 also deducted from rate base by DRA and PacifiCorp before applying the same debt cost  
8 factor. For CCFT purposes, it does not matter whether PacifiCorp is an option one or two  
9 company because there is no ITC available for CCFT purposes.

#### 10 **Investment Tax Credit (ITC)**

11 Public utilities are generally required to use one of two normalization methods to  
12 account for ITC for ratemaking purposes. Under option one, the benefits of ITC are  
13 flowed through to ratepayers by deducting deferred ITC from rate base and ratably  
14 restoring rate base over the book life of the plant which generated the ITC. Under option  
15 two, the benefits of ITC are ratably flowed through as a reduction of FIT. PacifiCorp  
16 accounts for property under option one, and the ITC amount was properly included as a  
17 reduction to rate base. Under current federal tax law, ITC must be amortized over the life  
18 of the underlying plant when estimating regulated federal income tax expense.

#### 19 **Miscellaneous Tax Credits**

20 PacifiCorp is entitled to recognize a federal income tax credit under IRC Section  
21 45(b)(2). This Renewable Energy Tax Credit is the result of placing its Wyoming Wind  
22 generating plant in service before December 31, 2001. The tax credit is based on the  
23 generation level of the plant and can reduce FIT for ten years on qualifying property.  
24 The credit was calculated by applying the most current renewable electricity production  
25 credit of 1.9 cents per kilowatt hour to the amount of electricity produced and sold from  
26 wind energy. PacifiCorp estimated a credit of \$2 million for the test year. DRA concurs  
27 with PacifiCorp's calculation.

#### 28 **American Jobs Creation Act of 2004**

29 In terms of both impact and number of provisions, the American Jobs Creation Act  
30 of 2004 (Act) is one of the most significant reforms of U.S. business taxation in twenty

1 years. The act created a new tax deduction for manufactures and added new Section 199  
2 to the Internal Revenue Code. The good news for ratepayers is that Congress broadly  
3 defined the term “manufacturers” as well as the underlying (qualifying) “production  
4 activities.”

5 The deduction is equal to a specified percentage applied to the lesser of (1)  
6 qualified production activities income for the year, or (2) taxable income for the year.  
7 The new deduction starts at a transition percentage of 3% for 2005 and 2006, and 6% for  
8 2007 through 2009 and when fully phased in by 2010 equal to 9%. The deduction is  
9 limited to 50% of the W-2 wages paid by the “manufacturer” for the tax year.

10 The impact of the legislation is that many public utilities now qualify as  
11 “manufacturers.” To further clarify the meaning “manufacturer,” the U.S. Treasury and  
12 the IRS should draft regulations explaining what business activities qualify as  
13 “manufacturing” for the new deduction as well as how to calculate the correct production  
14 activity income for the year. DRA’s interpretation, having studied the new legislation, is  
15 that qualifying activities include the producing of electricity, natural gas, or potable water  
16 in the United States. However, under the new law, domestic production revenues do not  
17 include gross receipts derived from the transmission or distribution of these items.  
18 Therefore, income from the production of electricity is qualified, whether the producing  
19 facility is part of a regulated utility or is an independent power facility. However, if the  
20 “manufacturer” is an integrated producer that generates electricity and delivers it to end  
21 users (ratepayers), then income that is properly attributable to the transmission of  
22 electricity from the generation facility to the final customers or to a point of local  
23 distribution does not qualify for the deduction.<sup>4</sup>

24 PacifiCorp provided an estimate of \$2.3 million for the Section 199 deduction for  
25 test year 2007. DRA recommends using this estimate for computing FIT cost of service.  
26 The deduction is a permanent item and not subject to a timing difference. As such, it  
27 should be fully flowed through to ratepayers in the form of an immediate tax deduction  
28 (schedule M adjustment). DRA recommends that any changes to this estimate should be

1 incorporated into the results of operations prior to the close of the record in this general  
2 rate case. DRA will expect a revision by PacifiCorp if circumstances warrant such a  
3 revision.

4 In addition to the Production Activity Deduction, two other tax benefits stemming  
5 from the American Jobs Creation Act of 2004 are included in the test year tax estimates.  
6 Tax amortization for Pollution Control Facilities is included as a deduction for regulated  
7 tax purposes (\$2.158 million). Secondly, tax depreciation includes depreciation on 15-  
8 year MACRS property for Transmission Assets that are 69kv and greater.

#### 9 **Payroll Taxes**

10 Payroll taxes and their respective rates and wage bases used in the results of  
11 operations are: Federal Insurance Contribution Act (FICA) 6.20%, \$95,247 wage cap;  
12 Medicare 1.45%, no wage cap. DRA agrees with these rates and wage bases.

#### 13 **Property Taxes**

14 PacifiCorp's property tax was forecasted by adjusting year to date accruals  
15 through March 2005 for known or anticipated changes in assessment valuations through  
16 December 2007. PacifiCorp's methodology and underlying assumptions were  
17 determined to be reasonable. Any differences between PacifiCorp and DRA are due to  
18 differences in the test year estimated plant additions.

---

(continued from previous page)

<sup>4</sup> House of Representatives Conference Report No. 108-755.