ORDER NO. 06-532

ENTERED 09/14/06

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

AR 499

In the Matter of	)	
	)	
Adoption of Permanent Rules to Implement SB 408 Relating to Utility Taxes.	)	ORDER

DISPOSITION: PERMANENT RULES ADOPTED

In this order, we adopt administrative rules, attached as Appendix A, necessary to implement Senate Bill 408 (SB 408). This bill, passed by the 2005 Legislative Assembly and generally codified at ORS 757.268,[1] requires certain public utilities to file annual tax reports and other information with the Public Utility Commission of Oregon (Commission). In this annual filing, the affected utilities[2] must identify the amount of income taxes paid, either by the public utility itself or its consolidated group and properly attributed to the utility, and the amount of taxes authorized to be collected in rates during specified time periods. If amounts collected and amounts paid differ by more than $100,000 for any utility, SB 408 requires this Commission to direct the public utility to implement a rate schedule with an automatic adjustment clause accounting for the difference.

This process of "truing up" a utility's cost for taxes constitutes a departure from ratemaking methods traditionally employed by the Commission. Instead of calculating taxes on a stand-alone basis, SB 408 requires this Commission to track the amount of taxes actually paid and determine what portion of those amounts are properly attributed to the regulated operations of the utility. Where taxes are paid on a consolidated basis by a utility parent, this task necessarily involves an apportionment of the paid taxes to all affiliates within a taxpaying entity, to ensure that ratepayers only pay the utility's share of the taxes paid.

Background

On April 10, 2006, the Commission filed a Notice of Proposed Rulemaking Hearing and Statement of Need and Fiscal Impact with the Secretary of

[1] This order generally refers to the part of the statute codified at ORS 757.268, in Section 3 of SB 408. References refer to citations of ORS 757.268.

[2] The affected utilities are Avista Utilities (Avista), Northwest Natural Gas Company (NW Natural), Portland General Electric Company (PGE), and Pacific Power & Light (PacifiCorp).

State. On April 21, 2006, notice was provided to certain legislators specified in ORS 183.335(1)(d) and to all interested persons on the service lists maintained pursuant to OAR 860-011-0001. Notice of the rulemaking was published in the *Oregon Bulletin* on May 1, 2006.

A number of participants contributed regularly in this docket, including the affected utilities, the Citizens' Utility Board (CUB), Industrial Customers of Northwest Utilities (ICNU), Northwest Industrial Gas Users (NWIGU), Utility Reform Project (URP), and the City of Portland. On September 15, 2005, we adopted temporary rules in Order No. 05-991. Subsequently, Administrative Law Judges and Commission staff (Staff) conducted several workshops and received public comments to assess legal issues associated with SB 408. At our request, the Oregon Attorney General issued a letter of advice addressing specified legal questions on December 27, 2005.

Rulemaking participants developed straw proposals on the definition of "properly attributed." After revision and comment, we held a workshop to discuss the merits of various interpretations of the law, whether an earnings test should be adopted, whether actual figures should be used for certain components of the "taxes authorized to be collected" calculation, whether deferred accounting and offsets from other deferred accounts should be used, and how Section (12)(a) should be interpreted.

On July 14, 2006, we entered an interim order proposing the adoption of the "Apportionment Method" to calculate taxes "properly attributed" to the utility. *See* Order No. 06-400. Rulemaking participants filed two additional rounds of comments in response to that interim order, and also participated in two workshops and a final rulemaking hearing on August 21, 2006.

COMMENTS AND DISCUSSION

Comments from rulemaking participants primarily focused on our proposed interpretation of "properly attributed." Other comments addressed the so-called "double whammy," the interpretation of Section (12)(a), and the date of accrual of interest for the automatic adjustment clause. We address these four issues separately.

I. "Properly Attributed"

In Order No. 06-400, we identified a method to determine taxes that are "properly attributed" to the utility. Specifically, we proposed the use of an adaptation of the three-factor method used by states to apportion the income of multi-state corporations for the purposes of assessing state income tax. Dubbed the "Apportionment Method," our adaptation apportions taxes paid by calculating the utility's amounts of payroll, property, and sales compared to the consolidated group's amounts for the same items. A combination of the three ratios would then be multiplied by the amount of taxes paid to units of government, yielding the utility's attributed portion.

In this order, we formally adopt the "Apportionment Method" to determine the amount of taxes paid that are properly attributed to the utility, specifically, the Oregon portion of the utility. In response to certain concerns raised by the rulemaking participants, however, we make certain modifications to this method for use in attributing taxes paid to the utility.

Normalization requirements

ORS 757.268(8) provides that, notwithstanding other sections of SB 408, "the commission may authorize a public utility to include in rates: (a) Deferred taxes resulting from accelerated depreciation or other tax treatment of utility investment; and (b) Tax requirements and benefits that are required to be included in order to ensure compliance with the normalization requirements of federal tax law." Rulemaking participants propose several modifications to the Apportionment Method to ensure that the normalization requirements are not violated, "even though the parties may have had differing understandings of what those requirements were." NW Natural Comments, 12 (July 31, 2006).

To ensure that normalization issues are simply eliminated from the calculation, PacifiCorp proposes that all regulated entities within the affiliated group, other than Oregon regulated operations, be excluded from the taxes paid calculation. *See* PacifiCorp comments, 8-9 (July 31, 2006). Avista suggests apportioning losses from non-regulated affiliates to regulated operations, rather than apportioning total taxes paid or, alternatively, adjusting "taxes paid" for deferred taxes before apportioning the taxes paid to the various affiliates. *See* Avista comments, 3-4 (July 31, 2006).

Staff, Avista, NW Natural, PacifiCorp, and PGE (Joint Parties), assert that "taxes paid" should be adjusted prior to apportionment for deferred taxes related to non-Oregon regulated operations. *See* Joint Comments, 4 (Aug 14, 2006). PacifiCorp also states that another "possible way to minimize normalization issues" is to add back the imputed tax benefit of tax depreciation on Oregon disallowed capital costs. *See* PacifiCorp comments, 3 (Aug 14, 2006).

PGE also notes the problem of passing along the accelerated depreciation amounts to customers, thereby violating normalization requirements, and putting the benefits of accelerated depreciation at risk. To address this concern, PGE proposes that utilities be allowed to make changes to their tax report filings to avoid normalization problems. *See* PGE comments, 11-12 (July 31, 2006). PacifiCorp also endorses the idea of allowing utilities to adjust their compliance filings as necessary "to address normalization risk." *See* PacifiCorp comments, 9 (July 31, 2006). ICNU proposes allowing utilities to identify tax normalization issues and possible solutions in their tax filings, for Commission review and approval. *See* ICNU comments, 7-8 (July 31, 2006). ICNU emphasizes, however, that any normalization adjustment "should be construed

narrowly to focus on compliance with normalization requirements as applied to regulated utilities and deferred taxes," and cautions against "attempts to expand [the authority to adjust for normalization issues] to address other issues." ICNU comments, 7 (Aug 14, 2006).

CUB requests an opportunity to review any letters submitted by utilities seeking Private Letter Rulings from the Internal Revenue Service (IRS) regarding normalization issues. *See* CUB comments, 9-10 (July 31, 2006). The Joint Parties also request that the deadline by which utilities must seek a Private Letter Ruling should be pushed back from October 15, 2006, to December 31, 2006. *See* Joint Comments, 9 (Aug 14, 2006).

Commission Resolution

ORS 757.268(8) provides that this Commission may allow a utility to recover all tax requirements and benefits necessary to ensure compliance with the normalization requirements of federal tax law. We agree that the Apportionment Method for determining properly attributed amounts could result in a violation of federal tax normalization requirements unless certain adjustments are made. Accordingly, we will modify the definition of "taxes paid" to remove all tax effects resulting from accelerated depreciation on public utility property. To accomplish this, the utility, in reporting taxes paid, will first remove the tax benefits of depreciation and federal investment tax credits by adding back the related tax effects to the amount of taxes paid to each taxing authority. *See* Appendix A, OAR 860-022-0041(2)(r) (adjustments for all taxes after apportionment); OAR 860-022-0041(3)(a)(A)(i) through (iii) (adjustments prior to apportionment for federal taxes), OAR 860-022-0041(3)(c)(A)(i) (adjustments prior to apportionment for state taxes), OAR 860-022-0041(3)(e)(A)(i) (adjustments prior to apportionment for local taxes), OAR 860-022-0041(4)(a) and (g) (amount of taxes paid to federal, state and local taxing authorities), OAR 860-022-0041(2)(n) and OAR 860-022-0041(4)(b) (calculation of stand-alone tax liability). When the final taxes paid amounts are calculated, an adjustment will be made to reflect the proper amount of current and deferred taxes related to Oregon regulated operations. *See* Appendix A, OAR 860-022-0041(4)(d) (adjustments to federal and state taxes paid), OAR 860-022-0041(4)(j) (adjustments to local taxes paid). These steps should ensure that no tax benefits flow to Oregon customers that would cause a violation of normalization requirements.

Further, we agree that utilities should have the flexibility to separately identify additional normalization issues as they arise, and propose solutions to those issues. We will then review possible normalization violations, decide whether to consider them and, if necessary, resolve them in an order establishing the amount of the automatic adjustment clause for that period. *See* Appendix A, OAR 860-022-0041(4)(o).

To facilitate review of utility letters seeking Private Letter Rulings from the IRS, we establish a deadline for draft letters to be submitted by the utilities to the

Commission and all participants in this docket on or before November 15, 2006. *See* Appendix A, OAR 860-022-0041(8)(g). Participants may review the letters and submit proposed edits and comments to all participants and the Commission on or before December 4, 2006. The Commission will review the proposed edits and work with the utilities on a final draft, to be submitted to the IRS on or before December 31, 2006. *See id.*

Other add-backs

ORS 757.268 provides for "add-backs" for certain items in determining "taxes paid." In addition to add-backs for deferred taxes, which must be added back to prevent a normalization violation, *see infra* 2-4, the statute allows for adding back of tax savings realized as a result of charitable contributions made by the Oregon utility and tax savings associated with investment by the utility in the regulated operations of the utility which have not yet been taken into account by the Commission in the utility's last general rate case. *See* ORS 757.268(13)(f)(A) and (B). The Commission has the discretion to add-back other items to "taxes paid" as part of the properly attributed calculation as a matter of policy.

NW Natural proposes additional add-backs be allowed, such as tax credits associated with renewable electricity production and business energy tax credits. *See* NW Natural Comments, 3 (July 31, 2006). PacifiCorp also suggests further add-backs, including all deferred taxes, tax credits, and charitable contributions incurred by non-regulated affiliates. *See* PacifiCorp comments, 9-10 (July 31, 2006). CUB agrees that certain add-backs should be made, including the Business Energy Tax Credit (BETC). *See* CUB straw proposal (April 11, 2006). ICNU opposes further modifications. It argues that, because add-backs were carefully selected by the Legislative Assembly, no additional add-backs should be considered. *See* ICNU comments, 7 (Aug 14, 2006).

Commission Resolution

In determining what amounts of taxes paid are properly attributed to the utility, we have broad discretion to include add-backs in addition to those identified by the legislature. We exercise this discretion to avoid unintended consequences that would be contrary to the public interest. Accordingly, we conclude that charitable contributions for all affiliates should be added-back prior to apportionment in order to not discourage worthy contributions. Further, we agree that certain tax credits should be added to taxes paid for purposes of determining amounts properly attributed to the utility. On the state level, we agree BETCs related to conservation and renewable resources for all affiliates should be added back so that these kinds of investments are encouraged. This will allow the benefits of these credits go to shareholders as intended under law and not be flowed through to ratepayers except when they bear the associated cost. On the federal level, Internal Revenue Code section 45 renewable electricity production tax credits for all affiliates should be added back prior to apportionment so that these credits do not go to

ratepayers. These credits are tied to tax policy to promote renewable energy sources, and, as a matter of policy, we exercise our discretion in adding them to "taxes paid" to determine the proper attribution of taxes paid by the utility.

Situs and Alternatives

In the interim order, we stated that the numerators for the ratios to determine the utility's portion of taxes paid should account for the utility's property, payroll, and sales in the state of Oregon. This was derived from the origination of the Apportionment Method, which was developed to determine a state's share of income from a multi-state corporation in order to apply that state's income tax.

Several rulemaking participants argue that the numerator should reflect all utility property, payroll, and sales used to provide regulated service for Oregon customers, including those amounts located or incurred outside the state of Oregon. *See, e.g.*, PGE comments, 8-9 (July 31, 2006), CUB comments, 4-7 (July 31, 2006), URP comments, 1 (Aug 14, 2006). Otherwise, CUB contends, to calculate the numerator according to the utility assets located solely in Oregon would result in "perverse incentives." CUB comments, public comment hearing (Aug 21, 2006).[3] For example, CUB explains that the resulting tax consequences may cause a utility to make a decision on the siting of a particular resource based on issues other than which location provides the least risk and cost for customers. ICNU opposes any deviation from our interim decision. It argues that, while the situs figures for the numerator are not precise, they approximate the taxes for which the utility's Oregon ratepayers are liable and should be used. *See* ICNU comments, 2-4 (Aug 14, 2006).

Commission Resolution

We agree with the majority of rulemaking participants that Oregon ratepayers should be responsible for the tax effects of all assets in rate base, whether located in Oregon or not. Regardless of their respective locations, all these assets have been approved by this Commission as necessary and useful in providing service to Oregon ratepayers. This requires an adjustment to the Apportionment Method. In the numerator, utilities should use the utility's gross plant, wages and salaries, and sales, as set forth in the utility's "results of operations" report to determine the amount of those ratios in relation to the entire consolidated entity's amount of payroll, property, and sales. That ratio will then be multiplied against the total taxes paid by the consolidated taxpayer, yielding the amount of taxes properly attributed to the utility. If necessary, this amount will be further adjusted to determine the amount of taxes attributed to the Oregon portion of a multi-state utility.

[3] The audio files for the August 21, 2006, public comment hearing can be found, as of the date of this order, at http://apps.puc.state.or.us/agenda/audio/2006/082106/default.htm.

Multi-State Tax Rate

The interim order also determined state taxes paid for the state of Oregon only. This is also a hold-over from the Apportionment Method's initial purpose of attributing taxes to Oregon alone. As noted above, however, utility resources used to serve Oregon customers are not necessarily located in Oregon. As several participants note, the interim order does not give proper consideration to taxes paid in other states on resources used to provide energy service to Oregon customers. For instance, PGE operates the Colstrip plant in Montana, which is used to provide electricity to Oregon customers. Therefore, the argument goes, Montana taxes, incurred at least in part by the Colstrip plant, should be properly attributed to the utility's regulated operations.

Participants put forth several solutions. One proposal requires the utility to calculate its proper attribution of taxes paid in each state where it has property, payroll, or sales used to provide service to Oregon customers. Another proposal allows the utility to calculate its proper attribution of taxes paid only in Oregon, but using an "effective tax rate" used to determine taxes collected in the rate case. Utilities have proposed allowing them to make the choice between the two options. *See* Joint Comments, 5-7 (Aug 14, 2006). Customer groups, however, are wary of allowing utilities to run both sets of numbers and then unilaterally choose which method to report, and note that utilities may not make the choice that is in the best interests of customers. *See* ICNU comments, public comment hearing (Aug 21, 2006).

Commission Resolution

We adopt the participants' proposal that we should consider state taxes paid on a wider basis than just those paid in Oregon, either by examining taxes paid in all states in which the utility pays state income taxes, or by an "effective tax rate" approach to taxes paid in Oregon. To resolve the concern of the customer groups, we require the utilities to make a one-time election and decide which methodology they will use to calculate their state taxes paid. *See* Appendix A, OAR 860-022-0041(3)(c)(C).

Apportionment of Local Taxes Paid

In the interim order, we decided that taxes paid should be apportioned at each level according to property, payroll, and sales, with the understanding that the multi-state companies would have those figures readily available on a statewide basis to calculate the portion of their income subject to each state's income taxes. Since then, we have learned that those factors are not necessarily calculated on a local basis. Instead, local taxes are determined by other measures.

NW Natural appears to argue that local taxes need not be apportioned, because they are essentially paid on a stand-alone basis and are collected only from impacted ratepayers in a separate surcharge. *See* NW Natural, 12 (July 31, 2006). PGE

also argues that local taxes should not be apportioned. *See* PGE comments, 9 (July 31, 2006). URP and ICNU oppose calculating local taxes paid on a stand-alone basis, and assert that local taxes should be apportioned. *See* URP comments, 2 (Aug 14, 2006); ICNU comments, 4-5 (Aug 14, 2006). Staff and the Joint Parties argue that local taxes should be apportioned, but not necessarily based on the same three factors used to apportion federal and state taxes. *See* Joint Comments, 7 (Aug 14, 2006).

Commission Resolution

The Apportionment Method was selected in part because the amounts for property, payroll, and sales would be readily available for other purposes, and could easily be used to calculate the utility's portion of taxes paid. Following that reasoning, we agree that it makes sense to apportion local taxes based on the factor used to assess those taxes. For example, the taxable income used to calculate the Multnomah County Business Income Tax (MCBIT) is apportioned based on gross income; therefore, determination of taxes properly attributed to the utility on the local level should be based on an apportionment by gross income for the MCBIT. *See* Appendix A, OAR 860-022-0041(3)(e)(B). If other local taxes arise, they too will be apportioned based on the factor used to assess those taxes, and will be dealt with on a case by case basis.

Lower Limit on Properly Attributed

The Joint Parties express concern that the Apportionment Method could yield a result in which customers receive more than 100 percent of the tax benefits from losses within the taxpaying group. *See* Joint Comments, 8 (Aug 14, 2006). To illustrate, the Joint Parties assume a utility has a stand-alone tax liability of $50 and a sole affiliate with a loss of $5. In this example, the utility's affiliated group's consolidated tax liability is $45. Application of the Apportionment Method, however, would produce a "properly attributed" amount lower than this $45 figure, because a portion of that consolidated tax liability would be attributed to the affiliate. To avoid this result, the Joint Parties recommend the Commission include a "floor" for the three-factor attributed amount. The proposed floor: the utility's stand-along tax liability minus the total amount of negative tax liabilities of affiliates in the applicable federal or state tax filing. *See id.*

Customer groups express concern about the inclusion of a floor. ICNU contends that any floor should be "narrowly tailored," beginning with the amount in ORS 757.268(12)(a) and attributing losses from all entities in the consolidated federal tax group. *See* ICNU comments, 8-9 (Aug 14, 2006). CUB opposes the proposed floor as an inappropriate limit on the method for properly attributing taxes that had been adopted by the Commission. CUB comments, public comment hearing (Aug 21, 2006).

Commission Resolution

The Apportionment Method allocates any taxes paid to all affiliates in the taxpaying group, including entities with no tax liability. As a result, we agree with the Joint Parties that this could produce a result in which customers receive more than 100 percent of the benefit from the tax losses of the utility's taypaying group. We agree with the Joint Parties that the Apportionment Method should be revised to preclude such an unjust result.

To provide a safety net against this result, we will include a "floor" beneath which the taxes paid that are properly attributed to the utility cannot fall. The floor will be calculated at the federal and state level by first determining the federal and state stand-alone tax liability for the utility. On the federal level, and at the state level for a utility with a multi-state tax rate, these amounts will then be reduced by the sum of the tax effects of all income tax losses of entities within the taxpaying group, as allocated to the Oregon operations of the utility using the ratios derived from the utility's gross plant, wages and salaries, and sales. On the state level for a utility for which Oregon state income taxes are the only state income taxes included in rates, the amounts equal to the stand-alone tax liability will be reduced by the sum of the tax benefits of all income tax losses of entities within the unitary group. These amounts will establish the lowest amounts of "taxes paid," determined under the Apportionment Method, that are properly attributed to the regulated operations of the utility. *See* Appendix A, OAR 860-022-0041(3)(b) (floor for federal taxes), OAR 860-022-0041(3)(d) (floor for state taxes).

Unitary Group

ORS 757.268 refers to the utility's "affiliated group," which includes every entity that is part of the consolidated federal tax return. *See* ORS 757.268(13)(a). The interim order stated that, to determine the "affiliated group" on the state level, "the various unitary groups that include entities in the consolidated federal return must be aggregated to determine the amount of taxes paid by the affiliated group in Oregon." Order No. 06-400, 6.

The participants agree that, rather than using all the state unitary groups as the taxpaying entity, the Commission should instead focus solely on the unitary group containing the utility. *See, e.g.*, CUB comments, 8 (July 31, 2006); PacifiCorp comments, 7 (July 31, 2006); Joint Parties, 7 (Aug 14, 2006). Staff adds that the Commission had discretion to use this single unitary group to calculate the properly attributed amount, and agrees that it would be "appropriate" because the unitary group is the taxpaying entity. *See* Staff comments, 2-3 (July 31, 2006).

Commission Resolution

We agree that taxes paid should be determined by the amount paid by the entity that includes the utility. On the state level, that means that state taxes should be gauged only by the amount paid by the unitary group that includes the utility.

II. "Double Whammy"

In Order No. 06-400, 8, we described the oft-discussed "double whammy" problem:

> The so-called "double whammy" situation arises because taxes vary with a utility's earnings. When lower than expected earnings reduce the amount of taxes that will be paid, provision of service is more expensive than was predicted in the rate case, and consumers pay less than the utility's actual costs. At the same time, customers will receive a SB 408 refund because income taxes are less than expected. Utilities argue that this result is unreasonable because it exacerbates their under-recovery and customers do not bear the higher cost of service. Conversely, when a utility's earnings are higher than expected as a result of higher revenues or lower costs, income taxes will also rise, and SB 408 requires a surcharge on ratepayers to compensate for those higher taxes. This would result in further increases in the utility's earnings.

We concluded that, while this is a difficult problem posed by SB 408, we believed, "that it would be contrary to the intent of the legislature to effectively offset the automatic adjustment clause so that it did not "adjust" rates, as it was designed to do. That is, the earnings test offset could net out the automatic adjustment clause." Order No. 06-400, 9.

After the interim order, utilities continue to express concern about the effect of the "double whammy." PacifiCorp suggests that the Commission allow utilities to add in the tax effect of expenses between rate cases to the extent there is a difference between the properly attributed amount and the stand-alone amount of taxes paid. *See* PacifiCorp comments, 8 (Aug 14, 2006). NW Natural urges the Commission to exercise its discretion to allow deferrals to mitigate the "double whammy" problem, or recommend a statutory solution to the next Legislative Assembly. *See* NW Natural comments, 13-14 (July 31, 2006). At the public comment hearing, ICNU questioned the utilities' characterization of the "double whammy" problem and disagreed that any remedies should be implemented in this rulemaking. *See* ICNU comments, public comment hearing (Aug 21, 2006).

Commission Resolution

We continue to believe that, as the agency charged with implementing SB 408, the proposed solutions to the "double whammy" problem may run contrary to the intent of the Legislative Assembly. However, as we stated earlier, we will be responsive to concerns related to the consequences of the "double whammy" problem, and may address those in ORS 756.040 proceedings, general rate cases, and power cost adjustment mechanism dockets. *See* Order No. 06-400, 9.

III. Section 12(a) Cap

ORS 757.268(12)(a) states that the amount of taxes properly attributed to a utility shall not exceed "[t]hat portion of the total taxes paid that is incurred as a result of income generated by the regulated operations of the utility." The Attorney General's letter of advice examined Section 12(a), and interpreted it as addressing "those taxes that would not have been received by units of government "but for" the existence of the regulated operations." Letter from Hardy Meyers, Or Atty Gen, to Lee Beyer, Commn Chair, at 15 (Dec 27, 2005) (available at http://www.puc.state.or.us/PUC/leg/sb408/index.shtml). In the interim order, we interpreted the Section 12(a) cap as best calculated by using the "With and Without" methodology proposed by PacifiCorp to determine what portion of taxes is directly tied to the utility. *See* Order No. 06-400, 4 n 3.

The utilities argue that we incorrectly interpreted Section 12(a). PGE asserted that the Section 12(a) cap was designed "to remove the effect of other tax group members to focus on what would have been the taxes paid by the stand-alone utility." PGE comments, 12 (July 31, 2006). Other utilities agree that Section 12(a) should be calculated based on the utility as a stand-alone entity. *See* PacifiCorp comments, 11-12 (July 31, 2006); NW Natural comments, 3 (Aug 14, 2006). Staff also agrees with that interpretation, asserting that the Commission has discretion in interpreting the cap in Section 12(a). *See* Joint Comments, 8 (Aug 14, 2006). ICNU argues that the Section 12(a) cap should include "all tax liabilities and credit that are supported, directly or indirectly, by the utility's regulated revenues." ICNU comments, 8 (July 31, 2006).

Commission Resolution

We agree with Staff that this Commission has discretion in interpreting the meaning of Section 12(a). In exercising that discretion, we may interpret the 12(a) cap as either a utility's stand-alone tax liability or as the amount produced under the "With and Without" methodology. There is little practical effect in choosing one interpretation over the other, however. The two interpretations will produce different amounts when all other members of the affiliated group together have a tax loss. In that case, however, the Section 12(b) cap will be no higher than either result produced under the competing interpretations of the Section 12(a) cap and, consequently, will establish the cap under

Section 12.[4] Due to this interaction between the Section 12(a) and 12(b) caps, and to simplify the Section 12(a) calculation, we will require the utilities to report the amount of stand-alone tax liability for purposes of the Section 12(a) cap. *See* Appendix A, OAR 860-022-0041(4)(b) (for federal and state taxes), OAR 860-022-0041(4)(h) (for local taxes).

IV. Date of Accrual of Interest

In the interim order, we stated that interest on the amount of the adjustment should begin to accrue on January 1 after the tax year for the difference for which the adjustment must be applied. For instance, a utility will track and report taxes collected and taxes paid for the year 2006 in a filing to be submitted on or before October 15, 2007. The Commission will then have 180 days to determine the amount of the automatic adjustment clause, which would take effect on June 1, 2008. Under the draft rule, interest would begin to accrue January 1, 2007. *See* Order No. 06-400, Draft Rule 9(e). PGE argues that interest should begin to accrue one year later, on January 1, 2008, to "dampen" volatile fluctuations that could have a harmful impact as a result of SB 408. *See* PGE comments, 13 (July 31, 2006).

Commission Resolution

SB 408's primary feature is a backward-looking true-up mechanism designed to align taxes paid with those collected from ratepayers. As explained above, this mechanism takes time to implement. Taxes collected in rates beginning in January 2006 will not be trued-up until June 2008. To ensure that neither utilities nor ratepayers are harmed by this delay, we find that interest should accrue as of the start date for the adjustment period. Thus, rather than the January 1, 2007 date proposed in Staff's proposed rules, circulated on July 25, 2006, we conclude that interest should begin to accrue for differences beginning January 1, 2006. The timing of the interest accrual is consistent with policies governing the accrual of interest on deferred accounts. *See* ORS 757.259. For purposes of calculating interest, we will assume that the mismatch of taxes paid with those collected accrues and accumulates evenly over the course of the entire tax year. Using this mid-year convention, interest will accrue on the amount of the annual difference as of July 1 of the tax year.

[4] In the example discussed above on page 8, the utility's stand-alone tax liability is $50 and the other affiliate(s) have a tax loss of $5. The "With and Without" approach to the Section 12(a) cap yields $45, since the group's tax liability is $45 with the utility and $0 without it. The "With and Without" cap is lower than a stand-alone approach to the Section 12(a) cap, but it is the same as the Section 12(b) cap, which is the affiliated group's tax payment.

ORDER

IT IS ORDERED that:

1. OAR 860-022-0041, as set forth in Appendix A, is adopted.

2. The rule shall become effective upon filing with the Secretary of State.

3. Avista Utilities, Northwest Natural Gas Company, Pacific Power & Light, and Portland General Electric Company shall file their tax reports on or before October 15, 2006, in compliance with the rule in Appendix A and this order.

4. Avista Utilities, Northwest Natural Gas Company, Pacific Power & Light, and Portland General Electric Company shall submit their draft requests for a Private Letter Ruling from the Internal Revenue Service to the Public Utility Commission of Oregon and all participants in this docket on or before November 15, 2006.

Made, entered, and effective SEP 14 2006.

Lee Beyer
Chairman

John Savage
Commissioner

Ray Baum
Commissioner

A person may petition the Commission for the amendment or repeal of a rule pursuant to ORS 183.390. A person may petition the Court of Appeals to determine the validity of a rule pursuant to ORS 183.400.

860-022-0041
Annual Tax Reports and Automatic Adjustment Clauses Relating to Utility Taxes

(1) This rule applies to regulated investor-owned utilities that provided electric or natural gas service to an average of 50,000 or more customers in Oregon in 2003, or to any successors in interest of those utilities that continue to be regulated investor-owned utilities.

(2) As used in this rule:

(a) "Affiliated group" has the meaning given to "affiliated group" in ORS 757.268(13)(a);

(b) "Deferred taxes" for purposes of the utility means the total deferred tax expense of regulated operations, as reported in the deferred tax expense accounts as defined by the Federal Energy Regulatory Commission, that relate to the year being reported in the utility's results of operations report or tax returns;

(c) "Income" means taxable income as determined by the applicable taxing authority, except that income means regulatory taxable income when reporting or computing the stand-alone tax liability resulting from a utility's regulated operations;

(d) "IRC" means Internal Revenue Code;

(e) "Investment" means capital outlays for utility property necessary or useful in providing regulated service to customers;

(f) "Local taxes collected" means the total amount collected by the utility from customers under the local tax line-item of customers' bills calculated on a separate city or county basis;

(g) "Pre-tax income" means the utility's net revenues before income taxes and interest expense, as determined by the Commission in a general rate proceeding;

(h) "Properly attributed" means the share of taxes paid that is apportioned to the regulated operations of the utility as calculated in section (3), subject to subsections (4)(a), (4)(b), (4)(g) and (4)(h), of this rule;

(i) "Public utility property" means property as defined by the Code of Federal Regulations, Title 26, Section 168(i)(10);

(j) "Regulated operations of the utility" has the meaning given to "regulated operations of the utility" in ORS 757.268(13)(c);

(k) "Results of operations report" means the utility's annual results of operations report filed with the Commission;

(l) "Revenue" means utility retail revenues received from ratepayers in Oregon, excluding supplemental schedules or other revenues not included in the utility's revenue requirement and adjusted for any rate adjustment imposed under this rule;

(m) "Revenue requirement" means the total revenue the Commission authorizes a utility an opportunity to recover in rates pursuant to a general rate proceeding or other general rate revision, including an annual automatic adjustment clause under ORS 757.210;

(n) "Stand-alone tax liability" means the amount of income tax liability calculated using a pro forma tax return and revenues and expenses in the utility's results of operations report for the year, except using zero depreciation expense for public utility property, excluding any tax effects from investment tax credits, and calculating interest expense in the manner used by the Commission in establishing rates;

(o) "System regulated operations" means those activities of the utility, in Oregon and other jurisdictions, that are subject to rate regulation by any state commission;

(p) "Tax" has the meaning given to "tax" in ORS 757.268(13)(d);

(q) "Taxes authorized to be collected in rates" means:

(A) The following for federal and state income taxes calculated by multiplying the following three values:

(i) The revenue the utility collects, as reported in the utility's results of operations report;

(ii) The ratio of the net revenues from regulated operations of the utility to gross revenues from regulated operations of the utility, calculated using the pre-tax income and revenue the Commission authorized in establishing rates and revenue requirement; and

(iii) The effective tax rate used by the Commission in establishing rates for the time period covered by the tax report as set forth in the most recent general rate order or other order that establishes an effective tax rate, calculated as the ratio of total income tax expense in revenue requirement to pre-tax income;

(B) For purposes of paragraph (2)(q)(A) of this rule, when the Commission has authorized a change during the tax year for gross revenues, net revenues or effective tax rate, the amount of taxes authorized to be collected in rates will be calculated using a weighted average of months in effect;

(r) "Taxes paid" has the meaning given to "taxes paid" in ORS 757.268(13)(f);

(s) "Taxpayer" means the utility, the affiliated group or the unitary group that files income tax returns with units of government;

(t) "Tax report" means the tax filing each utility must file with the Commission annually, on or before October 15 following the year for which the filing is being made, pursuant to ORS 757.268;

(u) "Unitary group" means the utility or the group of corporations of which the utility is a member that files a consolidated state income tax return; and

(v) "Units of government" means federal, state, and local taxing authorities.

(3) The amount of income taxes paid that is properly attributed to regulated operations of the utility is calculated as follows:

(a) The amount of federal income taxes paid to units of government that is properly attributed to the regulated operations of the utility is the product of the values in paragraphs (3)(a)(A) and (B), subject to subsection (3)(b) of this rule:

(A) The total amount of federal income taxes paid by the federal taxpayer, to which is added:

(i) The current tax benefit, at the statutory federal income tax rate, of tax depreciation on public utility property;

(ii) The tax benefits associated with federal investment tax credits related to public utility property; and

(iii) Imputed tax benefits on charitable contributions and IRC section 45 renewable electricity production tax credits of the affiliated group, except those tax benefits or credits associated with regulated operations of the utility; and

(B) The average of the ratios calculated for the utility's gross plant, wages and salaries and sales, using amounts allocated to regulated operations of the utility as set forth in the utility's results of operations report in the numerator and amounts for the federal taxpayer in the denominator;

(b) The amount of federal income taxes paid that is properly attributed to the regulated operations of the utility under subsection (3)(a) of this rule shall not be less than

the amount of the federal stand-alone tax liability calculated for the regulated operations of the utility, reduced by the product of:

(A) The imputed negative tax associated with all federal income tax losses of entities in the utility's federal taxpayer group, after making the adjustments in subparagraphs (3)(a)(A)(i) and (ii) of this rule; and

(B) The average of the ratios for the utility's gross plant, wages and salaries and sales, using amounts allocated to the regulated operations of the utility as set forth in the utility's results of operations report in the numerator and amounts for the system regulated operations in the denominator;

(c) The total amount of state income taxes paid to units of government that is properly attributed to the regulated operations of the utility is the product of the values in paragraphs (3)(c)(A) and (B), subject to paragraphs (3)(c)(C) and (D) and subsection (3)(d) of this rule:

(A) The total amount of Oregon income taxes paid by the Oregon unitary group taxpayer, to which is added:

(i) The current tax benefit, at the state statutory rate, of tax depreciation on public utility property; and

(ii) Imputed Oregon tax benefits on charitable contributions and state business energy tax credits related to conservation and renewable energy production of the unitary group, except those tax benefits or credits associated with regulated operations of the utility; and

(B) The average of the ratios calculated for the utility's gross plant, wages and salaries and sales using amounts allocated to regulated operations of the utility as set forth in the utility's results of operations report in the numerator and amounts for the unitary group taxpayer in Oregon, adjusted to reflect amounts allocated to regulated operations of the utility, in the denominator;

(C) If a utility's taxes collected in rates reflect non-Oregon state income taxes, the utility must make a one-time permanent election in its October 15, 2006, tax report filing to either:

(i) Multiply the total amount of Oregon income taxes paid in paragraph (3)(c)(A) of this rule before adjustments by the ratio calculated as the state income tax rate used by the Commission in establishing rates divided by the Oregon statutory tax rate set forth in ORS 317.061; or

(ii) Calculate the total state taxes paid using the formula set forth in paragraphs (3)(c)(A) and (B) of this rule on a state by state basis, apportioned to Oregon by multiplying the total state taxes paid by the average of the ratios calculated for gross plant, wages and salaries and sales using amounts allocated to the regulated operations of the utility in the numerator and amounts for the system regulated operations in the denominator;

(D) When Oregon income tax attributable to system regulated operations is 100 percent allocated to Oregon in setting rates, 100 percent of the Oregon income tax of system regulated operations must be attributed to the regulated operations of the utility;

(d) The amount of state income taxes paid that is properly attributed to the regulated utility operations of the utility under subsection (3)(c) of this rule must not be less than:

(A) For a utility for which Oregon state income taxes are the only state income taxes included in rates, the amount of the Oregon state stand-alone tax liability calculated for the regulated operations of the utility, minus the imputed negative tax associated with all

Oregon state income tax losses of entities in the utility's unitary group after making the adjustment in subparagraph (3)(c)(A)(i) of this rule; or

(B) For a utility for which non-Oregon state income taxes are included in rates, the product of:

(i) The sum of the state stand-alone tax liability calculated for the applicable system regulated operations in each state in which the utility is a member of a unitary group, minus the sum of the imputed negative tax associated with all state income tax losses of entities in the utility's unitary group in each state, after making the adjustment in subparagraph (3)(c)(A)(i) of this rule for each state; and

(ii) The average of the ratios calculated for gross plant, wages and salaries and sales using amounts allocated to the regulated operations of the utility in the numerator and amounts for the system regulated operations in the denominator;

(e) The amount of local income taxes paid to units of government that is properly attributed to the regulated operations of a utility is the product of the values in paragraphs (3)(e)(A) and (B) of this rule for each local taxing authority in Oregon:

(A) The total amount of income taxes paid by the taxpayer to the local taxing authority, as adjusted to include the imputed effect on local income taxes of:

(i) The current tax benefit of tax depreciation on public utility property; and

(ii) Imputed tax benefits on charitable contributions of the taxpayer except those associated with regulated operations of the utility; and

(B) The ratio calculated using the method for apportioning taxable income used by the local taxing authority, with the amount for the regulated operations of the utility in the local taxing authority in the numerator and the amount for the taxpayer in the local taxing authority in the denominator.

(4) On or before October 15 of each year, each utility must file a tax report with the Commission. The tax report must contain the following applicable information for each of the three preceding fiscal years:

(a) The amount of federal and state income taxes paid to units of government by the taxpayer, as adjusted pursuant to subparagraphs (3)(a)(A)(i) and (ii) of this rule;

(b) The amount of the utility's federal and state income taxes paid that is incurred as a result of income generated by the regulated operations of the utility, where:

(A) The amount of federal income taxes paid is equal to the federal stand-alone tax liability calculated for the regulated operations of the utility;

(B) For a utility for which Oregon state income taxes are the only state income taxes included in rates, the utility's state income taxes paid is the Oregon state stand-alone tax liability calculated for the regulated operations of the utility; and

(C) For a utility for which non-Oregon state income taxes are included in rates, the amount of state income taxes paid is the product of:

(i) The sum of the state stand-alone tax liability calculated for the applicable system regulated operations in each state in which the utility is a member of a unitary group; and

(ii) The ratio calculated as the income of the regulated operations of the utility divided by the income of the system regulated operations;

(c) The amount of federal and state income taxes paid to units of government by the taxpayer that is properly attributed to the regulated operations of the utility, as calculated in section (3) of this rule;

(d) The lowest of the amounts in subsections (4)(a), (4)(b) and (4)(c) of this rule, after making adjustments for:

(A) The items defined in subsection (2)(r) of this rule;

(B) A reduction equal to the current tax benefit related to tax depreciation of public utility property for regulated operations of the utility; and

(C) A reduction equal to the tax benefit related to federal investment tax credits recognized by the Commission in establishing rates;

(e) The amount of federal and state income taxes authorized to be collected in rates;

(f) The amount of the difference between the amounts in subsections (4)(d) and (4)(e) of this rule;

(g) The amount of local income taxes paid to units of government by the taxpayer, calculated for each local taxing authority, and to which is added the imputed effect on local income taxes of the amount in subparagraph (3)(e)(A)(i) of this rule;

(h) The amount of local income taxes paid to units of government by the taxpayer that is incurred as a result of income generated by the regulated operations of the utility, calculated as the stand-alone tax liability in each local taxing authority;

(i) The amount of local income taxes paid to units of government by the taxpayer that is properly attributed to the regulated operations of the utility, as calculated in section (3) of this rule for each local taxing authority;

(j) The lowest of the amounts in subsections (4)(g), (4)(h) and (4)(i) of this rule, calculated for each local taxing authority, after making adjustments for:

(A) The items defined in subsection (2)(r) of this rule; and

(B) A reduction equal to the local tax effect of the current tax benefit related to tax depreciation of public utility property for regulated operations of the utility;

(k) The amount of local income taxes collected from Oregon customers, calculated for each local taxing authority;

(l) The amount of the difference between the amounts in subsection (4)(j) and (4)(k) of this rule, calculated for each local taxing authority;

(m) The proposed surcharge or surcredit rate adjustments for each customer rate schedule to charge or refund customers the amount of the differences in subsections (4)(f) and (4)(l) of this rule;

(n) If the utility claims the minimum taxes paid amount set by subsections (3)(b) and (3)(d) of this rule, the total federal and state income tax losses in the utility's affiliated and unitary groups associated with the imputed negative tax claimed; and

(o) Any adjustments, in addition to the adjustments required in section (3) and subsections (4)(a) through (4)(n) of this rule, that the utility proposes to avoid probable violations of federal tax normalization requirements.

(5) In calculating the amount of taxes paid under sections (3) and (4) of this rule:

(a) "Taxes paid" must be allocated to each tax year employed by the utility for reporting its tax liability in the following manner:

(A) For any tax return prepared for the preceding tax year and filed on or before the date the tax report is due for such tax year, the utility must allocate each reported tax liability to the tax year for which such return is filed;

(B) For each tax liability or tax adjustment shown on an amended tax return or made as a result of a tax audit, that is filed, paid or received after the date the tax report is due

for the applicable tax year, the utility must allocate the tax liability or tax adjustment to the tax year that is recognized by the utility for accounting purposes;

(C) Taxes paid must include any interest paid to or interest received from units of government with respect to tax liabilities;

(b) When a utility's fiscal year or parent changes, and a partial year consolidated federal income tax return is filed during the year, taxes paid must be calculated in the manner defined by ORS 314.355 and OAR 150-314.355. For purposes of this rule, the amount of taxes paid must reflect a weighted average of the months in effect related to each tax return filing.

(6) The utility must explain the method used for calculating the amounts in this rule and provide copies of all workpapers and documents supporting the calculations.

(7) The Commission will establish an ongoing docket for each of the October 15 tax report filings. Upon signing a protective order prepared by the Commission, any intervenor may have access to all such tax report filings, subject to the terms of the protective order;

(a) Within 20 days following the tax report filings, an Administrative Law Judge will conduct a conference and adopt a schedule;

(b) Within 180 days of the tax report filings, the Commission will issue an order that contains the following findings:

(A) Whether the taxes authorized to be collected in rates for any of the three preceding fiscal years differs by $100,000 or more from the amount of taxes paid to units of government that is properly attributed to the regulated operations of the utility;

(B) For the preceding fiscal year, the difference between the amount of federal and state income taxes paid to units of government by the taxpayer that is properly attributed to the regulated operations of the utility and the amount of taxes authorized to be collected in rates;

(C) For the preceding fiscal year, the difference between the amount of local income taxes paid to units of government by the taxpayer that is properly attributed to the regulated operations of the utility and the amount of local taxes collected in rates; and

(c) Any other finding or determination necessary to implement the automatic adjustment clause.

(8) Upon entry of an order finding a difference of $100,000 or more in section (7) of this rule, the utility must file an amended tariff, to be effective each June 1 unless otherwise authorized by the Commission, to implement a rate adjustment applying to taxes paid to units of government and collected from ratepayers for each fiscal year beginning on or after January 1, 2006;

(a) The utility must establish a balancing account and automatic adjustment clause tariff to recover or refund the difference determined by the Commission in paragraph (7)(b)(B) of this rule through a surcharge or surcredit rate adjustment;

(b) A utility that is assessed a local income tax must establish a separate balancing account and automatic adjustment clause tariff for each local taxing authority assessing such tax. The utility must apply a surcharge or surcredit on the bills of customers within the local taxing authority assessing the tax. The amount of the surcharge or surcredit must be calculated to recover or refund the difference determined by the Commission in paragraph (7)(b)(C) of this rule;

(c) Any rate adjustment must be calculated to amortize the difference determined by the Commission in paragraphs (7)(b)(B) and (7)(b)(C) of this rule over a period authorized by the Commission;

(d) Any rate adjustment must be allocated by customer rate schedule according to equal percentage of margin for natural gas utilities and equal cents per kilowatt-hour for electric utilities, unless otherwise authorized by the Commission;

(e) Each balancing account must accrue interest at the Commission-authorized rate for deferred accounts. For purposes of calculating interest, the amount of the difference calculated in this section of the rule will be deemed to be added to the balancing account on July 1 of the tax year;

(f) The automatic adjustment clause must not operate in a manner that allocates to customers any portion of the benefits of deferred taxes resulting from accelerated depreciation or other tax treatment of utility investment or regulated affiliate investment required to ensure compliance with the normalization method of accounting or any other requirements of federal tax law;

(g) On or before December 31, 2006, each utility must seek a Private Letter Ruling from the Internal Revenue Service on whether the utility's compliance with ORS 757.268 or this rule would cause the utility to fail to comply with any provision of federal tax law, including normalization requirements. Each utility must file a draft of its Private Letter Ruling Request with the Commission on or before November 15, 2006. While a utility's request for a Private Letter Ruling is pending, or a related Revenue Ruling is pending, no rate adjustment will be implemented, but interest will accrue according to subsection (8)(e) of this rule on the amount of any rate adjustment determined by the Commission pursuant to paragraphs (7)(b)(B) and (7)(b)(C) of this rule.

(9) No later than 30 days following the Commission's findings in section (7) of this rule, any person may petition to terminate the automatic adjustment clause on the basis that it would result in a material adverse effect on customers. In the event of a filing under this section, the applicable rate adjustment will not be implemented until the Commission makes its determination. If the Commission denies the request to terminate the rate adjustment, interest will accrue according to subsection (8)(e) of this rule on the final amount of the rate adjustment.

(10) At any time, a utility may file a claim that a rate adjustment under the automatic adjustment clause violates ORS 756.040 or other applicable law. In making a determination regarding a potential violation of ORS 756.040, the Commission will perform an earnings review using the utility's results of operations report for the applicable tax year.

Stat. Auth.: ORS Ch. 183, 756, 757 & 759
Stats. Implemented: ORS 756.040, 756.060, 757.267 & 757.268
Hist.: NEW