ITEM NO.

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: September 14, 2005

REGULAR X CONSENT ____ EFFECTIVE DATE Upon Filing with the Secretary of State

DATE: September 7, 2005

TO: Public Utility Commission

FROM: Judy Johnson

THROUGH: Lee Sparling, Ed Busch and Terry Lambeth

SUBJECT: AR 498: Requests approval of temporary rule to implement Senate Bill 408.

STAFF RECOMMENDATION:

I recommend the Commission approve temporary rule OAR 860-022-0039 to implement legislative changes regarding the filing of annual tax reports and automatic adjustment clauses relating to public utility taxes.

DISCUSSION:

The 2005 legislature passed Senate Bill 408 which requires public utilities to file annual tax reports and other tax information with the Commission. The bill requires the report to provide information concerning the amount of taxes paid by the public utility and the amount of taxes authorized to be collected in rates during specified time periods. Further, the bill requires the Commission to review the report and determine if the amount of taxes assumed in rates differed by at least $100,000 from the amount of taxes paid by the public utility to units of government. SB 408 directs the Commission, upon finding that difference in amounts, to require the public utility to implement a rate schedule with an automatic adjustment clause accounting for the difference.[1]

The purpose of this temporary rule in AR 498 is to establish the filing requirements for the first tax report due October 15, 2005. These issues, and others relating to the details of the potential automatic adjustment clause, will be further reviewed in the permanent rulemaking, AR 499. The permanent rulemaking will begin with a series of three workshops. Parties will also have the opportunity to provide two rounds of comments as well as provide input at a public comment hearing.

[1] In this memo, I will generally refer to "regulated operations of the utility" as the "utility."

Staff sent out questions about SB 408 to interested parties concerned with electric and natural gas issues. We received comments back from PacifiCorp, Portland General Electric (PGE), Avista, and NW Natural. Some issues raised by parties' comments will be addressed in this memo.

Definition of "Properly Attributed." This definition is crucial to determining the amount of taxes paid "attributable" to the public utility, which will be compared to the amount of taxes in rates. This attribution is required for the tax report by Sections 3(1) and 3(4) of SB 408 and for the automatic adjustment clause by Section 3(6). Section 3(7) further requires a determination of the amount "properly attributed to any unregulated affiliate of the public utility or to the parent of the utility" in applying the automatic adjustment clause.

In response to staff's questions, PGE and PacifiCorp both indicated the public utility's stand-alone tax liability, up to the amount of the consolidated tax payment, should be used as the amount of taxes paid to government units that is properly attributed to the utility.[2] This attribution approach would remedy the Enron-type situation that proponents of the bill cited. Staff, however, believes this approach would lead to unreasonable outcomes in certain circumstances. Consider the following example[3]:

	Stand-Alone Tax Liability	PGE/PacifiCorp Proposed Attribution
Regulated Utility Operations	130	130
Affiliate X	130	70
Affiliate Y	-60[4]	
Consolidated Tax Payment	200	200

As shown, the PGE/PacifiCorp stand-alone approach would attribute the public utility's stand-alone tax liability of 130 as the public utility's "taxes paid." However, this also would mean that Affiliate X, with the same stand-alone tax liability as the public utility, could be attributed no more than 70 (that is, the 200 consolidated payment minus the public utility's 130 attribution). This is not a logical result. It is also inconsistent with Section 3(7) that requires a "properly attributed" calculation for unregulated affiliates. Although Section 3(7) refers to the automatic adjustment clause, staff can find no

[2] Avista also raised an issue regarding allocating state taxes according to the apportionment method used by the Oregon Department of Revenue. This issue should be evaluated in the permanent rulemaking.
[3] The amount attributed to regulated operations would also be adjusted for charitable contributions, tax credits and deferred taxes as directed by Section 3(13)(f) in SB 408.
[4] Affiliate Y's tax liability on a stand-alone basis is actually zero due to negative taxable income, but is shown as negative to illustrate the effect on the consolidated tax payment.

reason why there would be a different interpretation of "properly attributed" for the tax report than for the automatic adjustment clause.

A more equitable approach, which is similar to the approach the Pennsylvania PUC uses for allocating tax benefits, is to determine an attribution or allocation based on the stand-alone tax liability of the affiliates that have a positive tax liability. In the example above, both the regulated utility and Affiliate X would be allocated 100, or one-half of the total consolidated tax payment. Staff recommends the Commission adopt its approach for "properly attributed" in the temporary rules and revisit this issue in the permanent rulemaking.

Definition of "Effective Tax Rate." PacifiCorp and PGE define effective tax rate using both current and deferred taxes. However, staff believes that both the taxes collected in rates and the taxes paid before adjustments should be calculated without deferred taxes. The difference between the two amounts would then be adjusted by deferred taxes under Section 3(13)(f)(C), to insure that deferred taxes are fully recovered in rates as required by Section 3(8) in SB 408.

Taxes Included in Tax Report. Section 3(13)(d) defines "Tax" as "a federal, state or local tax or fee that is imposed on or measured by income…" For the temporary rules, staff defines "income" as net revenues or taxable income, which will result in the tax report including federal, state and local income taxes.

One of staff's questions to the parties was how local income taxes, which are collected as a line item in the bill rather than in a public utility's base rates, should be considered in calculating "Taxes authorized to be collected in rates" under Section 3(13)(e). PGE responded that because local income taxes are not included in revenues in a public utility's rate case, they should not be included in the "authorized to be collected" calculation. PacifiCorp stated that because local income taxes fall under the definition of a "tax" in Section 3(13)(d), they should be included in the "authorized to be collected" calculation as well as the "taxes paid" calculation.

Staff agrees with PacifiCorp that the definition of "tax" requires local income taxes to be included in the tax report as amounts both "authorized to be collected" and "taxes paid." However, as PGE implies, the calculations of the ratio of net revenues to gross revenues and the effective tax rate "used by the Commission in establishing rates" under Section 3(13)(e) do not include the effect of local income taxes, because they are not recovered in base rates. As a result, "taxes authorized to be collected in rates" will not be directly comparable to the "taxes paid" amount and may lead to unexpected results in the tax report. The treatment of local income taxes under SB 408 should be thoroughly assessed in the permanent rulemaking.

Staff's proposed temporary rule is attached as Appendix A. When the temporary rule has expired, no more than 180 days after adoption, a permanent rule in AR 499 will be ready to take its place.

PROPOSED COMMISSION MOTION:

Temporary rule OAR 860-022-0039 to implement legislative changes regarding Senate Bill 408 be approved.

860-022-0039
Annual Tax Reports and Automatic Adjustment Clauses Relating to Public Utility Taxes
(1) This rule applies to any regulated investor-owned utility, or successor in interest, that provided electric or natural gas service to an average of 50,000 or more customers in Oregon in 2003.
(2) As used in this rule:
(a) "Affiliated group" means an affiliated group of corporations of which the public utility is a member and that files a consolidated federal income tax return.
(b) "Deferred taxes" means the total deferred tax expense of regulated operations as reported in the appropriate FERC deferred tax expense accounts that relate to the year being reported.
(c) "Income" means net revenues or taxable income after deducting expenses, before taxes subject to this rule.
(d) "Properly attributed" means the product determined by multiplying the following two values:
(A) The total amount of taxes paid by the public utility or affiliated group to units of government; and
(B) The ratio of the tax liability of Oregon regulated operations of the public utility to the total tax liability from all affiliates of the public utility or the affiliated group with a positive tax liability.
(e) "Regulated operations of the utility" means those activities of a public utility that are subject to rate regulation by the Commission.
(f) "Tax" means a federal, state or local tax or fee that is imposed on or measured by income.
(g) "Taxes authorized to be collected in rates" means the product determined by multiplying the following three values, calculated excluding deferred income taxes and the revenues and costs related to sales for resale:
(A) The revenues the public utility collects from ratepayers in Oregon, adjusted for any rate adjustment imposed under this rule;
(B) The ratio of the net revenues from regulated operations of the public utility to gross revenues from regulated operations of the public utility, as determined by the Commission in establishing rates; and
(C) The effective tax rate used by the Commission in establishing rates, calculated as the ratio of taxes to income.
(h) "Taxes paid" means net amounts received by units of government from the public utility or from the affiliated group and properly attributed to regulated operations of the public utility, adjusted as follows:
(A) Increased by the amount of tax savings realized as a result of charitable contribution deductions allowed because of the charitable contributions made by the public utility;

(B) Increased by the amount of tax savings realized as a result of tax credits associated with investment by the public utility in the regulated operations of the public utility, to the extent the expenditures giving rise to the tax credits and tax savings resulting from the tax credits have not been taken into account by the Commission in the public utility's last general ratemaking proceeding; and
(C) Adjusted by deferred taxes related to the regulated operations of the public utility.
(i) "Units of government" mean federal, state and local taxing authorities.
(3) By October 15 each year, each public utility will file a tax report with the Commission. The tax report will contain the following information for each of the three preceding fiscal years:
(a) The amount of taxes paid to units of government by the public utility or its affiliated group, without regard to the tax year for which the taxes were paid;
(b) The amount in section (3)(a) of this rule that is properly attributed to Oregon regulated operations of the public utility;
(c) The amount of tax liability of Oregon regulated operations of the public utility calculated on a stand-alone basis using Oregon results of operations;
(d) The amount of taxes authorized to be collected in rates for Oregon regulated operations of the public utility; and
(e) All supporting workpapers and documents supporting the calculations.
(4) Each public utility will provide any information the Commission requires to make the determination in section (6) of this rule.
(5) The Commission may disclose, or any intervenor may obtain and disclose, the amount by which the amount of taxes that units of government received from the public utility or from the affiliated group differed from the amount of costs for taxes collected, directly or indirectly, as part of rates paid by customers, including whether the difference is positive or negative. An intervenor may not disclose any further information unless the Commission allows the disclosure. The Commission will not authorize disclosure of any information that is exempt from disclosure under the Public Records Law ORS 192.410 – 192.505.
(6) Within 180 days following the filing of the public utility's tax report, the Commission will determine whether the taxes authorized to be collected in rates for any of the three preceding fiscal years differed by $100,000 or more from the amount of taxes paid to units of government that are properly attributed to the Oregon regulated operations of the public utility.
(7) If the Commission makes a finding of a difference of $100,000 or more in section (6) of this rule, the Commission will require the public utility to make a compliance filing establishing an automatic adjustment clause tariff to be effective within 60 days of the finding.
(8) If the Commission determines that an automatic adjustment clause would have a material adverse effect on customers of the public utility, the Commission

will issue an order terminating the automatic adjustment clause. The order will set forth the reasons for the Commission's determination.

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