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November 1, 2007

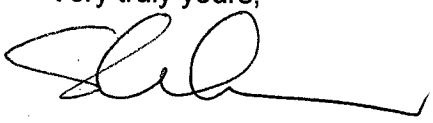
VIA ELECTRONIC FILING

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

Re: Docket AR 517

Pursuant to Order No. 07-401 in docket AR 517, enclosed is PacifiCorp's draft supplemental PLR request. A copy of this filing has been served on all parties to this docket as indicated on the attached certificate of service.

Very truly yours,



Sarah J. Adams

Enclosures
cc: Service List

CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing document in Docket AR 517 on the following named person(s) on the date indicated below by email and first-class mail addressed to said person(s) at his or her last-known address(es) indicated below.

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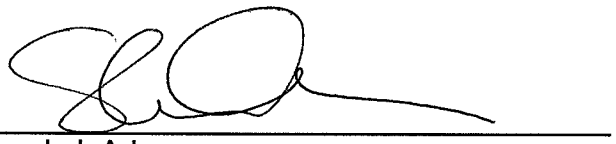
DATED: November 1, 2007.



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DRAFT

October 29, 2007

Patrick Kirwan
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1111 Constitution Avenue, NW
Washington, DC 20224

Dear Pat:

On or about December 29, 2006 PacifiCorp ("Taxpayer") submitted a request to the IRS Associate Chief Counsel Office. In this request, Taxpayer sought rulings regarding the implications under the normalization rules (Code §168(i)(9), former Code §167(l) and former Code §46(f)) of certain State of Oregon legislation (SB 408) and its associated implementing regulations. This legislation and these regulations govern the calculation of, *inter alia*, the federal income tax expense element of cost of service for purposes of setting rates. The ruling request accurately described and addressed the Oregon rules as they existed on the date of the submission.

Recently, the Public Utility Commission of Oregon ("PUCO") issued Order No. 07-401 in Docket AR 517 which amended the relevant regulations. A copy of Order No. 07-401 is attached. There are five alterations that are effected by this Order, three of which impact the calculation of the federal income tax expense element of cost of service and, thereby, have the capacity to implicate the normalization rules. In order to insure that any ruling issued by your office is based on a complete and accurate set of facts and on a comprehensive analysis of these facts, there follows a brief description of these three alterations together with Taxpayer's assessment of any potential normalization implications that may be involved. We ask that you incorporate these facts and this explanation into the ruling request and factor it into your consideration, as appropriate.

The three amendments that can impact the calculation of the federal income tax element of cost of service are: (1) the "Iterative Effect" amendment, (2) the "Negative Current" amendment and (3) the "Floor Calculation" amendment. Each amendment will be described and analyzed. Page references are all to the copy of Order AR 517 attached.[1]

The "Iterative Effect" Amendment (pages 2-3)

As indicated on page 7 of Taxpayer's ruling request, SB 408 and its implementing regulations included a "true up" mechanism. Under this mechanism, taxes which are authorized to be collected in rates during a period are compared to taxes paid that are attributable to the utility operations (as computed under the regulations) during the same period. To the extent that there is a difference that equals or exceeds $100,000, then a refund or additional collection is required. The Iterative Effect addresses the "circular" effect of this adjustment. For example, if a refund is ordered, then there will be a reduction in taxable income on that account. If that reduction is then cycled through the "true up" procedure, an additional "true up" refund would be required. And so on. To prevent this from happening, the regulations were amended to exclude the tax effect of any prior "true up" from inclusion in the "true up" procedure.

Taxpayer does not believe that this amendment has any consequences under the normalization rules. Therefore, Taxpayer does not believe that this amendment requires consideration in your analysis of its ruling request.

The "Negative Current" Amendment (pages 4-6)

As is described at length starting on page 4 of Taxpayer's ruling request, SB 408 and its regulations prescribe a highly complex system for determining the quantity of income tax that is "properly attributable" to Taxpayer's Oregon regulated utility operations. This system includes three alternative calculations, the lowest of which represents the "properly attributable" amount. The mechanics of the third of these alternative calculations, Method 3 (Consolidated/Apportioned)[2] is the subject of this amendment.

Method 3 starts with the consolidated tax liability, adds back the tax effect of all depreciation and ITC on public utility property ("PUP"), and then multiplies the result by a fraction that represents a composite of the sales, property and payroll factors (the "three factor formula") for the utility operations. This sum is then compared to a floor amount (the "standalone floor") and the larger of the two amounts is selected. The amount so selected is then reduced by the tax effect of PUP depreciation on Oregon assets, increased by the establishment of deferred taxes and reduced by regulatory ITC amortization. This procedure is further described in the ruling request at page 6.

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[1] Taxpayer appended to its ruling request as Exhibit 4 an excerpt from a template prepared by the Staff of the Public Utility Commission of Oregon which demonstrates the operation of the calculations called for by the applicable regulations. The Staff has added an additional page to that template to reflect the amendments described in this submission. Taxpayer would be pleased to provide this page to you upon request.

[2] A description of Method 3 is set out on page 6 of Taxpayer's ruling request.

At or about the time it finalized its ruling request, Taxpayer and others recognized a mathematical characteristic of Method 3. The apportionment accomplished by application of the "three factor formula" is, obviously, not based on items of income and expense. Consequently, the amount of tax that is apportioned by that mechanism is mathematically unlinked from the conventional factors that determine a tax liability and can reflect an amount that is unrelated to the level of taxable income incurred by the regulated operation. The tax amount apportioned by application of the "three factor formula" when decreased by the tax benefit of Oregon PUP depreciation represents the "currently payable" component of tax expense. It is mathematically possible for this amount to be negative (*i.e.*, to reflect a tax recovery – a deemed refund from the government) even where there is no consolidated tax loss and no utility standalone tax loss. When this occurs, the total apportioned tax (current and deferred) will be less than the utility's deferred tax requirement. A numerical example that illustrates such a situation is attached. In the example, the apportioned current tax expense is -$159, the deferred tax requirement is $140 and the total apportioned tax expense is -$19. In a situation such as this, where the apportioned current tax is negative, it was feared that the reduction of the deferred tax requirement by this negative current tax provision could be viewed as tantamount to an inadequate provision of deferred taxes – including those deferred taxes required by the normalization rules. Having been advised of this potential issue, the Commission amended the regulations to provide that, in no event can the total tax expense apportioned pursuant to Method 3 be less than the deferred tax expense element of cost of service (*i.e.*, the current tax provision cannot be negative).

The purpose of this amendment, the avoidance of a normalization violation, was endorsed by all rulemaking participants including the Commission Staff, the Oregon utilities as well as the Industrial Customers of Northwest Utilities. It is remedial in nature. It represents a response to a perceived normalization issue and provides a solution to it. The amendment is clearly relevant to your normalization analysis insofar as it eliminates a potential weakness in the normalization structure of the Method 3 apportionment system.

The "Floor Calculation" Amendment (pages 8-10)

This amendment clarified, but did not change, one aspect of the Method 3 calculation – the computation of the standalone floor. The description of the standalone floor calculation in Taxpayer's ruling request[3] as well as the illustration of its operation in the Method 3 analysis (at page 16 of the ruling request) are both completely consistent with this amendment.

Consequently, this amendment changes neither the facts nor the analysis contained in the ruling request in any way.

SB 408 requires the PUCO to issue an order no later than April 15, 2008 for the tax reports filed for the tax year 2006, with the associated rate adjustments due to take effect June 1, 2008. However, the applicable regulations prohibit implementation of any such rate adjustments while this ruling request is pending.

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[3] See Adjustment 4 and the associated footnote on page 6 of Taxpayer's ruling request.

We appreciate your attention to this matter and stand ready to provide to you any additional information, explanations and/or analyses you might require. If you believe that it would be helpful to hold an informational meeting to facilitate your understanding of the rather complex statutory and regulatory framework involved in this matter, we would be pleased to accommodate you. In this regard, please feel free to call me at 212-603-2072.

The Staff of the PUCO and organizations representing customer groups have participated in the preparation of this submission by reviewing and providing comments on a prior draft.

Thanking you for your courtesy and attention, I remain,

Sincerely,

James I. Warren

JIW/at

NY #1202866 v1

PENALTIES OF PERJURY STATEMENT

Under penalties of perjury, I declare that I have examined this modification to Taxpayer's ruling request, including accompanying documents, and, to the best of my knowledge and belief, the modification contains all the relevant facts relating to the request, and such facts are true, correct, and complete.

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_____

ORDER NO. 07-401

ENTERED 09/18/07

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

AR 517

In the Matter of Housekeeping and Clarification Changes to OAR 860-022-0041.	)))	ORDER

DISPOSITION: RULE AMENDED

In this order, the Public Utility Commission of Oregon (Commission) amends OAR 860-022-0041 governing Annual Tax Reports and Automatic Adjustment Clauses Relating to Utility Taxes. The amended rule, attached as Appendix A, will become effective upon filing with the Secretary of State and will be used by utilities in making their October 15 tax filings.

Background

Senate Bill 408, passed by the 2005 Legislative Assembly, establishes a new method for the rate treatment of utility income taxes. Generally, SB 408 requires a utility to true-up any differences between the amounts of income taxes collected in rates from customers and amounts of taxes paid to the government that are "properly attributed" to the utility's regulated operations. *See* ORS 757.268(4). If amounts collected and amounts paid differ by more than $100,000, the utility must adjust rates accordingly through an automatic adjustment clause. *See* ORS 757.268 (4), (6)(a).

To implement SB 408, we adopted OAR 860-022-0041. *See* AR 499, Order No. 06-532. The rule set forth procedures for quantifying taxes that are "properly attributed" to the utility, as well as other items necessary to determine whether tax-related rate adjustments are necessary. In adopting the rule, we made efforts to ensure that utilities would retain all tax benefits necessary to comply with the normalization requirements of federal tax law. *See* ORS 757.268(8). To this end, we directed the affected utilities to seek private letter rulings from the Internal Revenue Service (IRS) as to whether compliance with the adopted rule would cause the utility to fail to comply with any provision of the normalization rules. *See* Order No. 06-532 at 4. Those requests are currently pending before the IRS.

Following the adoption of OAR 860-022-0041, the AR 499 rulemaking participants identified the need to make certain "housekeeping" amendments to the rule. They also explored whether other amendments should be made to address the normalization issue and recently enacted legislation relating to Oregon business energy tax credits (BETCs). Following a series of informal workshops, the Commission Staff (Staff) proposed rule amendments addressing five separate issues.

On June 14, 2007, the Commission filed a Notice of Proposed Rulemaking Hearing and Statement of Need and Fiscal Impact with the Secretary of State. The Commission also provided notice to 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 July 1, 2007.

On July 31, 2007, the Commission held a hearing on the proposed rulemaking. Representatives from PacifiCorp, dba Pacific Power (PacifiCorp); Portland General Electric Company (PGE); Northwest Natural Gas Company, dba NW Natural (NW Natural); Avista Corporation, dba Avista Utilities (Avista Utilities); Industrial Customers of Northwest Utilities (ICNU); and Staff appeared and provided comments. The rulemaking participants also submitted written opening comments on July 18, 2007, and reply comments on August 10, 2007.

DISCUSSION

The notice of proposed rulemaking identified amendments to OAR 860-022-0041 to address the following issues: (1) to remove an iterative effect caused by calculating a tax effect on the amount either refunded or collected from customers; (2) to allow a change in methodology if ownership of the utility changes; (3) to remove a potential federal tax law normalization problem caused by drawing down current deferred taxes; (4) to reflect legislative changes relating to the treatment of the BETC tax credit; and (5) to correct the calculation of the "floor" for the three-factor Apportionment Method. We address each issue separately.

I. Iterative Effect

Staff Proposal

Staff proposes three amendments to address the so-called "iterative effect" that occurs when SB 408-related rate adjustments are taxed as increased or decreased revenue in subsequent years. To prevent the possibility of rate adjustments caused solely by SB 408-related adjustments, Staff first proposes that "iterative tax effect" be added in a new subsection in (2)(g). That proposed definition reads:

> **(g) "Iterative tax effect" means the tax effect of a rate adjustment for taxes related to ORS 757.267 or ORS 757.268 in the tax reporting period that includes the rate adjustment;**

Next, Staff proposes amending the definition of "deferred taxes" in subsection (2)(b) to eliminate the iterative effect under the automatic adjustment clause:

> (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**, excluding deferred taxes related to the establishment of a regulatory receivable or payable account for any rate adjustment imposed under ORS 757.268, in the year the deferred tax is established but not thereafter, to eliminate the iterative tax effect of the rate adjustment**;

Finally, Staff proposes amendments to paragraphs (4)(d)(E) and (4)(j)(C) to require utilities to remove the iterative effect when calculating the amount of taxes paid.

Comments

All utilities support Staff's proposed amendments to remove the iterative effect. ICNU also supports the goal of Staff's proposed amendments, but cautions that the Commission should carefully scrutinize any adjustments made to eliminate the iterative tax effect to ensure that such adjustments are consistent with the narrow intent of these amendments. Specifically, ICNU contends that adjustments for iterative tax effects should be limited to "rate adjustments made through the automatic adjustment clause called for in SB 408 rather than adjustments to base rates in general rate cases." ICNU Opening Comments, pg 2 (July 18, 2007).

Resolution

We adopt Staff's proposed amendments. As PacifiCorp explains, the fair and rational operation of SB 408 requires the elimination of iterative tax effects. We note that Staff's draft rule in AR 499 contained similar provisions to remove the iterative effect under SB 408. *See* AR 499 Draft Rule Revisions, 2 (July 17, 2006). No participant opposed that provision, and its omission in the final rule appears to have been inadvertent. We make a minor housekeeping change to both paragraph (4)(d)(E) and (4)(j)(C) to correct the word "subsection" to "paragraph."

We reject ICNU's proposed narrow interpretation of "iterative tax effect." The definition in (2)(g) refers generally to "the tax effect of a rate adjustment for taxes related to ORS 757.267 or ORS 757.268." We interpret this language to mean any rate adjustment made pursuant to SB 408, whether accomplished through the automotive adjustment clause set forth in ORS 757.268, or through an adjustment to base rates pursuant to ORS 757.267.

II. One-Time Election

Staff Proposal

Currently, OAR 860-022-0041(3)(c)(C) provides two alternative methodologies for calculating multi-sate tax rates and requires a utility to make a one-time election as to what method it will use. Staff proposes the rule be amended to allow a utility the opportunity to change its election if it is purchased by a new owner. Specifically, Staff proposes the rule be amended as follows:

(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, **or in the case of a utility ownership change pursuant to ORS 757.511, in the first tax report filing that includes a tax reporting period reflecting the new ownership,** to either:

Comments

All rulemaking participants support Staff's proposed amendment to allow a new utility owner the opportunity to make an election between the two methodologies. PacifiCorp and PGE, however, make one clarification as to the intended scope of the change. While ORS 757.511 governs actual changes in utility ownership as well as changes in affiliate status, the amendment is intended to apply only when there is a *bona fide* change of ownership. The utilities define a *bona fide* change in ownership as a change in ownership of 51 percent or more of the utility's voting shares.

Resolution

We agree that a new utility owner should be allowed the opportunity to revisit the election of which methodology to use in calculating the multi-state tax rate. We revise Staff's proposed amendment, however, to eliminate any ambiguity as to its intended scope. Staff's proposed amendment is revised to read:

(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, **or in the case of a change of the majority ownership of the utility's voting shares ~~utility ownership change~~ pursuant to ORS 757.511, in the first tax report filing that includes a tax reporting period reflecting the new ownership,** to either:

III. Drawing Down Current Deferred Taxes

Staff Proposal

As discussed above, the rule adopted in AR 499 defines the amount of taxes paid that are "properly attributed" to the Oregon regulated operations of the utility. Generally, this amount is defined as the "lesser of" amount of three alternative calculations: (1) the utility's "stand-alone" tax liability; (2) the total consolidated tax liability of the affiliated group; and (3) the total consolidated tax liability of the affiliated group as apportioned under a methodology the compares the respective amounts of the utility's and affiliated groups amounts of payroll, property and sales. This latter methodology has been dubbed the "Apportionment Method." *See generally* Order No. 06-532 at 2.

During the preparation of the utilities' Private Letter Ruling (PLR) requests, the AR 499 participants discovered that the Apportionment Method could operate in such a manner to produce a negative amount for taxes paid. To avoid such a result—one that would likely result in a normalization violation—Staff proposes OAR 860-022-0041(4)(d) be modified to replace any negative taxes paid result with $0. As revised, OAR 860-022-0041(4)(d) would read:

> (d) The lowest of the amounts in subsections (4)(a), (4)(b) and (4)(c) of this rule, after making adjustments ~~for~~ **in paragraphs (4)(d)(A), (4)(d)(B), (4)(d)(C), (4)(d)(D), and (4)(d)(E), but no less than the deferred taxes related to depreciation of public utility property for regulated operations of the utility, except the deferred tax amount must be reduced by any tax refunds recognized in the reporting period and apportioned to the regulated operations of the utility**:

This amendment precludes a "taxes paid" result that falls below the level of the utility's deferred taxes related to the depreciation of its public utility property (PUP).

Comments

All rulemaking participants agree that a rule change to eliminate a negative "taxes paid" result is necessary to protect against a violation of normalization standards. All support Staff's proposal, which they characterize as the most important amendment in this rulemaking.

The utilities, however, contend that the amendment should go further to strengthen the protection against a normalization violation. They believe that Staff's proposal may be inadequate, as it provides the absolute minimum amount of required protection with no margin for error. They also express concern about how the Internal Revenue Service (IRS) may interpret Staff's proposed language to reduce the deferred tax amount by the amount of any tax refunds "apportioned" to the utility. The utilities believe that "apportioned" may be interpreted to mean apportioned based on the Apportionment Method factors, which would reduce deferred taxes by an amount not tied to the utility's tax accounting methodologies. They also question the continued—albeit modified—use of a methodology that produces a flawed result.

To provide greater protection against a normalization violation, the utilities propose an amendment that would preclude the use of any methodology that produces a negative current taxes paid result in a given year. In other words, rather than arbitrarily setting current taxes paid at zero, the utilities propose the Commission invalidate any calculation producing a negative taxes paid amount and, in such a case, rely solely on a comparison of the remaining two calculations in the "lesser of" analysis to determine the final taxes paid amount. They believe this approach is more fundamentally sound and provides a more conservative solution to the identified problem with existing rule. Given its simplicity, the utilities also suggest that this proposal provides a clearer, easier approach for the IRS to review and approve the PLR requests.

Resolution

We agree with the rulemaking participants that, as the rule is currently written, the calculation of taxes paid could produce a negative taxes paid amount. As PacifiCorp notes, its PLR includes such an example where the stand-alone result is $490, the consolidated result is $468, and the Apportionment Methodology result is -$19. While such a result might represent an unusual example, the fact that it is plausible requires a change in our rule to prevent a likely violation of normalization requirements.

Any amendment, however, must be consistent with our prior determination as to what amounts are "properly attributed" to the Oregon regulated operations of a utility. In the AR 499 rulemaking, we concluded the Apportionment Method provided a sound basis for calculating taxes paid by a utility, because it fairly balances the interests of the utility and its ratepayers. *See* Order Nos. 06-532 and 06-400.

For this reason, we reject the utilities' proposal, which would eliminate the use of the Apportionment Method when it results in a negative taxes paid amount. Such an amendment would, in our opinion, detrimentally impact the balance of interests between the utility and its ratepayers that the Apportionment Method provides. Indeed, the invalidation of the Apportionment Method could result in a considerable difference in the taxes paid amount under our rules. For instance, in the example cited in PacifiCorp's PLR request, the amount of taxes paid would significantly increase to $468, the amount calculated under the consolidated result.

Accordingly, we adopt Staff's proposed amendment. As the utilities acknowledge, Staff's proposal to reset any negative result to zero safeguards against potential normalization violations associated with the reduction of deferred taxes. This change eliminates the possibility that any tax benefits related to deferred taxes on PUP will be passed through to customers. Unlike the utilities' proposal, the amendment also retains the use of the Apportionment Method for purposes of determining amounts properly attributed to the utility. Thus, Staff's proposal both protects against normalization violations while also adhering to our prior determination that the Apportionment Method best reflects the amounts of taxes "properly attributed" to the utility.

In reaching this decision, we acknowledge the utilities' concern about the possible misinterpretation of the use "apportioned" in Staff's proposed rule change and will replace that word with "allocated." We do not agree, however, with the utilities' other arguments that we should adopt a "stronger response" to protect against a normalization violation. At issue is whether the rule could be interpreted as flowing through in rates any tax benefit related to deferred taxes on PUP. As Staff points out, either it does or it does not—it is not a matter of degree. Staff's amendments to eliminate the possibility of a negative "taxes paid" amount sufficiently ensure the answer to that question is "it does not."

IV. BETCs

Staff Proposal

SB 408 allows this Commission, in determining amounts of taxes paid that are "properly attributed" to the utility, to add-back of tax savings realized as a result of charitable contributions and other tax savings realized as a result of tax credits. *See* ORS 757.268(13)(f)(A) and (B). In exercising this discretion, we concluded, in part, that tax credits associated with BETCs should be added back when determining taxes paid. We explained:

> 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.

Order No. 06-532 at 5.

After our rulemaking, the 2007 Legislative Assembly expanded the scope of Oregon's BETC law. To ensure that the provisions of SB 408 do not discourage utilities from making BETC investments, the Assembly, in HB 3201,[1] amended ORS 469.206(3) by adding the following language:

> Notwithstanding any other provision of law, a tax credit transferred pursuant to this section does not decrease the amount of taxes required to be reported by a public utility.

Staff and the utilities read this amendment as requiring an add-back of all purchased BETCs from the operation of SB 408—not just those BETCs related to conservation and renewable resources. Accordingly, Staff proposes amending OAR 860-022-0041 to require, when determining the amount of taxes paid that is properly attributed to the utility, to add-back all BETC credits. Specifically, Staff proposes the "properly attributed" calculation include the following adjustment identified in paragraph 4(d)(D):

> **An increase equal to the tax benefit of Oregon business energy tax credits, including those credits transferred pursuant to ORS 469.206 and ORS 469.208, of the unitary group, excluding those credits covered by subsection (4)(d)(A); and**

Comments

All utilities support Staff's proposed amendment to expand the add-back requirement to all BETCs. They explain that utilities generally purchase BETCs as a service to

[1] The Governor signed HB 3201 into law on July 31, 2007.

customers to promote energy efficiency. Without Staff's amendment, they claim that utilities will not be able to provide this service.

ICNU opposes Staff's proposal and contends the Commission should retain the add-back limit to conservation and renewable resources. It also contends that customers should retain the benefit of any BETC if customers are paying, in rates, for the action that gives rise to the credit.

Resolution

We adopt Staff's proposed amendments with one clarifying revision to modify the amendment to refer specifically to the tax credit portion of the law, ORS 757.268(13)(f)(B), instead of "Subsection (4)(d)(A)"of the rule. We agree that an expansion of the add-back provision to cover all BETCs is required under HB 3201. Moreover, we agree that the amendment is required to align the party that pays for the BETCs with the party that enjoys the tax benefit.

Contrary to ICNU's apparent belief, this amendment applies only to benefits obtained when a utility purchases a BETC on behalf of other entities. It does not apply to BETCs the utility may acquire due to its own capital investments or internal operations. Consequently, ICNU's concern is misplaced. As the PGE and PacifiCorp explain, the utility's shareholders—not ratepayers—pay the cost of purchasing BETCs not related to utility service.

V. Calculation of Floor for Apportionment Method

Staff Proposal

The AR 499 rule establishes a "floor" for the Apportionment Method to avoid a result whereby Oregon customers receive more than 100 percent of the benefit from the tax losses of the utility's taxpaying group. The calculation of the floor begins with the stand-alone tax liability for the utility's Oregon regulated operations, which is then reduced by an apportioned share of the imputed negative tax of all losses of the taxpayer group. To guard against a normalization violation, the rule also requires the utilities to add-back any tax related benefits of depreciation and investment tax credits (ITC). *See* OAR 860-022-0041(3)(b)(A); OAR 860-022-0041(3)(d)(A) and (B)(i).

Staff believes that these provisions provide an improper result by requiring the utilities to add back all tax benefits from PUP depreciation, not just those benefits related to regulated utilities with losses. Staff first contends that the rule goes beyond what is necessary to protect against a normalization violation. Second, because the tax effect of depreciation on all PUP would, in most cases, more than offset the taxpaying entity's losses, Staff contends that this floor calculation would equal the utility's stand-alone tax liability and result in the effective elimination of the Apportionment Method.

Accordingly, Staff proposes a correction to the floor calculation that limits the add-back of tax benefits related to PUP depreciation to individual regulated entities in the taxpaying group with losses. In other words, the proposed rule changes modify the floor calculation by adding back the identified tax benefits only to the extent those benefits were included in the income tax losses used to reduce the original "stand-alone" tax liability calculation.

Comments

ICNU support Staff's proposal. The utilities oppose it, and argue that the proposed amendments will increase the risk of normalization violations. Generally, the utilities contend that the modified rule fails to present a clear and complete isolation of all PUP depreciation and ITC and decreases the buffer effect the floor has on extreme results under the Apportionment Method. They argue that the continuation of the Commission's conservative approach toward normalization is the safest way to obtain a favorable and timely response from the IRS on the utilities' respective PLRs.

Resolution

We adopt Staff's proposed amendments. We agree that removing tax related benefits for depreciation and ITC from the floor calculation only for those regulated entities that have losses is consistent with our original intent in adopting the AR 499 rule. As Staff notes, the pending PLR request reflects this intent in its description of the floor calculation:

> The standalone floor is the amount that results after Adjustment 2 of Method 1 (an adjusted standalone tax liability) reduced by an allocation of the imputed negative tax liability with tax losses. This imputed negative tax liability is computed after eliminating depreciation and ITC *claimed by each loss affiliate with respect to its PUP.*

PacifiCorp Request for Private Letter Ruling, pg 6 (Dec. 29, 2006) (emphasis added).

The utilities' assertion that the modified floor calculation does not isolate all PUP depreciation and ITC is based on an erroneous interpretation of the rule. As noted above, the floor calculation begins with the stand-alone tax liability of Oregon operations, which is defined as to exclude all tax benefits resulting from PUP. *See* OAR 860-022-0041(2). The calculation then reduces the stand-alone liability by the Oregon regulated operations share of all losses in the taxpaying group. We agree with Staff that:

> If the effects of tax benefits from public utility property are brought into the floor calculation, that amount must be removed through an "add back." If those benefits are not included in the floor calculation in the first place, there's no need to do any add back.

Staff's Reply Comments, pg 4 (Aug 10, 2007) (emphasis in original).

CONCLUSION

Staff's proposed rule changes are adopted, with the minor modifications noted herein. These rule amendments will improve our administration and implementation of Senate Bill 408. Moreover, at our Staff's request, they have been reviewed by an independent tax expert, who agrees that the rule amendments will protect against a violation of federal tax law normalization requirements.

We appreciate the rulemaking participants' efforts to improve our rules. We also acknowledge that unanticipated issues may likely emerge as the law begins to operate. Accordingly, we remind the utilities to identify in their tax reports any unanticipated normalization concerns and to propose solutions to those concerns. The early identification and reporting of such issues, contemplated in OAR 860-022-0041(4)(o), will help the Commission and interested parties address unanticipated problems in a manner that will not delay implementation of any required tax-related rate adjustment.

ORDER

IT IS ORDERED that:

(1) The rule amendments set forth in Appendix A, are adopted and become effective upon filing with the Secretary of State.

(2) PacifiCorp, dba Pacific Power, Portland General Electric Company, Northwest Natural Gas Company, and Avista Corporation, dba Avista Utilities, shall submit draft amended requests for a Private Letter Ruling from the Internal Revenue Service to this Commission and all participants in this docket on or before November 1, 2007.

(3) Participants shall submit proposed edits and comments on the draft amended requests for Private Letter Ruling to this Commission on or before November 15, 2007.

(4) PacifiCorp, dba Pacific Power, Portland General Electric Company, Northwest Natural Gas Company, and Avista Corporation, dba Avista Utilities, shall submit final requests for a Private Letter Ruling to the Internal Revenue Service by November 30, 2007.

Made, entered, and effective SEP 18 2007.

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**, excluding deferred taxes related to the establishment of a regulatory receivable or payable account for any rate adjustment imposed under ORS 757.268, in the year the deferred tax is established but not thereafter, to eliminate the iterative tax effect of the rate adjustment**;

(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) "Income tax losses" means the negative taxable income of an entity in the federal taxpayer or unity group, excluding the current deduction of tax depreciation on public utility property and federal investment tax credits related to public utility property;

(~~d~~**e**) "IRC" means Internal Revenue Code;

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

(g) "Iterative tax effect" means the tax effect of a rate adjustment for taxes related to ORS 757.267 or ORS 757.268 in the tax reporting period that includes the rate adjustment;

(~~f~~**h**) "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;

(**gi**) "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~~**j**) "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~~**k**) "Public utility property" means property as defined by the Code of Federal Regulations, Title 26, ~~s~~Section 168(i)(10);

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

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

(~~l~~**n**) "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~~o) "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~~p) "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~~q) "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~~r) "Tax" has the meaning given to "tax" in ORS 757.268(13)(d);

(~~q~~s) "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~~s)(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~~t) "Taxes paid" has the meaning given to "taxes paid" in ORS 757.268(13)(f);

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

(~~t~~v) "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~~w) "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~~x) "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, **or in the case of a change of the majority ownership of the utility's voting shares pursuant to ORS 757.511, in the first tax report filing that includes a tax reporting period reflecting the new ownership,** 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) **and (iii)** 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~~ **in paragraphs (4)(d)(A), (4)(d)(B), (4)(d)(C), (4)(d)(D), and (4)(d)(E), but no less than the deferred taxes related to depreciation of public utility property for regulated operations of the utility, except the deferred tax amount must be reduced by any tax refunds recognized in the reporting period and allocated to the regulated operations of the utility**:

(A) The items defined in subsection (2)(~~r~~**t**) 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;

(D) An increase equal to the tax benefit of Oregon business energy tax credits, including those credits transferred pursuant to ORS 469.206 and ORS 469.208, of the unitary group, excluding those credits covered by ORS 757.268(13)(f)(B); and

(E) Elimination of the iterative tax effect to the extent such iterative tax effect has not been eliminated by paragraph (4)(d)(A) of this rule;

(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~~**t**) 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; **and**

(C) Elimination of the iterative tax effect to the extent such iterative tax effect has not been eliminated by paragraph (4)(j)(A) of this rule;

(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