ITEM NO. CA1

**PUBLIC UTILITY COMMISSION OF OREGON**
**STAFF REPORT**
**PUBLIC MEETING DATE: May 4, 2021**

**REGULAR ____ CONSENT X EFFECTIVE DATE October 30, 2020**

**DATE:** April 15, 2021

**TO:** Public Utility Commission

**FROM:** John Fox

**THROUGH:** Bryan Conway, John Crider, and Matt Muldoon **SIGNED**

**SUBJECT:** AVISTA UTILITIES:
(Docket No. UM 2124)
Application for Authorization to Approve Federal Income Tax Expense for Certain Plant Basis Adjustments Changes and to Defer Associated Change in Tax Expense.

## STAFF RECOMMENDATION:

Staff recommends that the Commission approve Avista Corporation dba Avista Utilities' (Avista or Company) Application for Authorization to Approve Federal Income Tax Expense for Certain Plant Basis Adjustments Changes, effective May 5, 2021. Staff recommends that the Commission approve Avista's Application to Defer Associated Changes in Tax Expense, with the clarifications in Avista's supplemental filing, for the twelve-month period beginning October 30, 2020.

## DISCUSSION:

Issues

1. Whether the Commission should authorize the Company to use the flow-through method of accounting for certain income tax benefits which are currently included in customer rates using tax normalization; and
2. Whether the Commission should authorize deferral of the income tax benefits resulting from this change in accounting for future ratemaking consideration.

Applicable Rule or Law

As provided in ORS 757.120(1), every public utility is required to keep uniform accounts of all business transacted in the manner and form prescribed by the Commission. Importantly, "No public utility shall keep any other accounts or records of its public utility business transacted than those prescribed or approved by the commission except such as may be required by the laws of the United States." ORS 757.125(2).

OAR 860-027-0055 adopts the uniform system of accounts prescribed for Natural Gas Companies in Part 201, Chapter 1, 18 Code of Federal Regulations. Therefore, a public utility must receive an accounting order from the Commission if it seeks to depart from the accounting method prescribed by the Commission.

Under ORS 757.259, the Commission may authorize deferred accounting for later incorporation in rates. Specific amounts eligible for deferred accounting treatment with interest authorized by the Commission include:

> Identifiable utility expenses or revenues, the recovery or refund of which the commission finds should be deferred in order to minimize the frequency of rate changes or the fluctuation of rate levels or to match appropriately the costs borne by and benefits received by ratepayers.

ORS 757.259(2)(e).

Under ORS 757.259, the Commission may authorize deferred accounting for later incorporation in rates. In OAR 860-027-0300(3) the Commission has set forth the requirements for the contents of deferred accounting applications. Applications for reauthorization must include that information along with a description and explanation of the entries in the deferred account to the date of the application for reauthorization and the reason for continuation of deferred accounting. OAR 860-027-0300(4). Notice of the application must be provided pursuant to OAR 860-027-0300(6).

Unless subject to an automatic adjustment clause under ORS 757.210(1), amounts deferred under ORS 757.259(5) and OAR 860-027-0300 are allowed in rates only to the extent authorized by the Commission in a proceeding under ORS 757.210 to change rates and upon a prudence review and review of the utility's earnings. With some exceptions, a company's amortization of amounts deferred under ORS 757.259(5) cannot exceed an amount equal to three percent of the company's gross revenues from the preceding year. ORS 757.259(6).

In Order No. 05-1070, Docket No. UM 1147, the Commission determined that interest may accrue interest on deferred accounts at the authorized rate of return until amortization. Subsequent orders in Docket No. UM 1147 establish the rate during amortization. See Order Nos. 08-263, 10-279.

## Analysis

*Application*
Avista's application in this docket states:

> Avista is currently calculating federal income taxes utilizing the normalization method for the majority of plant-related temporary book-to-tax differences. This proposal would allow Avista to utilize the flow-through method on certain plant basis adjustments, which will provide immediate benefits to customers. With this application, the Company is proposing to defer those benefits and to begin to provide those benefits to customers in its next filed general rate case.[1]

The application further states that:

> A normalized book-to-tax difference is a temporary difference that for accounting purposes adjusts current income tax expense and has an equal offset in deferred income tax expense, thus the net effect to total book income tax expense is zero. A flow-through book-to-tax difference is also a temporary difference that adjusts current income tax expense, but does not have an offsetting deferred income tax expense amount.[2]

Avista also cites two Internal Revenue Service (IRS) private letter rulings, the work of outside consultants, and Company's formal request to the IRS requesting a change in accounting method.

The Company estimates that $19.5 million of accumulated deferred federal income taxes (ADFIT) will be initially available for return to rate payers as a result of this change, as well as $1.6 million per year of additional ratepayer benefits on an ongoing basis beginning in 2020.[3] As stated in the application, these estimates include gross-up for federal taxes.

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1 Application at 1.
2 Application at 4.
3 Application at 9-10.

*Normalization Considerations*

The IRS has described the intent of normalization as follows:

> Congress had two principal objectives in adopting the Normalization Rules. The first objective was to preserve the utility's incentive to invest. Congress enacted the ITC and accelerated depreciation to stimulate investment. These incentives were not intended to subsidize the consumption of any products or services, including utility products or services. Recognizing that public utility rates are set based on the utility's costs incurred to provide the utility service, including federal income tax expense, Congress enacted a set of rules to assure that some or all of the value of the incentives it provided for utility capital investment would not be diverted from investment by utilities to lower prices for consumption by customers of utilities.
>
> The second objective was to protect the government's tax revenue. Congress reasoned that when a utility elected accelerated depreciation and its regulator lowered rates to reflect the resulting tax benefit, the federal government would experience a reduction in tax revenue twice: once from the added accelerated depreciation deductions taken by the utility, and again from the decline in the revenue received by the utility as a result of its lower rates.[4]

Staff review of the tax work papers provided in the Company's most recent general rate case[5] indicate the following annual tax benefits currently flow through directly to Oregon ratepayers:

- Postretirement benefits (FAS 106) $34 thousand
- Other flow through items ($36) thousand

Staff notes that the annual reduction in tax expense resulting from this docket, if approved, would be significantly more than the amounts currently subject to flow through treatment for ratemaking.

With that background in mind, Staff is not aware of any reason to question the determination of Avista and its professional advisors that a change in accounting method is allowable under IRS normalization rules for the plant basis adjustments cited in the application.[6] Furthermore, as the proposed accounting order would provide a

[4] Revenue Procedure 2017-47, Safe Harbor for Inadvertent Normalization Violations, at 2.

[5] See In the Matter of AVISTA CORPORATION, dba AVISTA UTILITIES, Request for a General Rate Revision, Docket No. UG 389, Order No. 20-468, Dec 10, 2020.

[6] Industry Director Directive No. 5 (IDD #5) and meters.

significant acceleration of rate payer benefits and the Company clearly discloses flow through details in its rate case filings, Staff is inclined to recommend approval.

*Position of Interested Stakeholders*
The Alliance of Western Energy Consumers (AWEC) petitioned to intervene in the docket. AWEC conducted discovery and expressed concerns regarding the consideration given to the associated state tax benefits as the accounting method change will effectively eliminate Oregon taxable income for the next several years.

*Resolution*
Avista, AWEC, and Staff participated in discussions of this filing on March 12 and March 26, 2021.

Avista agrees to expressly include in the deferral associated state tax savings in the amount of approximately $1.3 million per year [7] starting on January 15, 2021, which was the effective date of the base rate increase in the Company's last rate case. Avista provided supplemental information regarding the benefits associated with Oregon state income taxes in a filing on April 20, 2021.

Staff notes that the Company states in its application that it will not implement a change in accounting until all three states have approved the use of the flow through method, but requested a decision by May 1.[8] The Idaho Public Utilities Commission approved Avista's application on February 1, 2021, with its Order No. 34906. The Washington Utilities and Transportation Commission approved Avista's application on March 11, 2021. The Commission's approval in this docket will be the last of the three jurisdictions and allow the Company to effect this change in accounting by May 5, 2021.

*Proposed Accounting*
For the federal income taxes, Avista proposes to record the deferred amount as a net regulatory liability by debiting FERC Account 282 (ADFIT), and crediting FERC Account 254.3 (Regulatory Liability). Interest will not accrue on the balance since the amount will be included as a reduction to rate base.

For the state income taxes, Avista proposed to record the deferred amount as a regulatory liability by debiting FERC Account 407 (Regulatory Debit) and crediting FERC Account 254 (Regulatory Liability). Interest will be accrued on the balance at the approved authorized rate of return (ROR).

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7 The total state tax benefit is less than state taxes included in Order No. 20-468 due to plant removed in the subsequent compliance filing and also reflects that the Company will still need to pay the $75,000 minimum Oregon excise tax each year.

8 Application at 12-13.

*Estimated Deferral in Authorization Period*

Description of Expense
As described above, the amount subject to deferral is the following:

- For federal income taxes, the Company estimates that $19.5 million of ADFIT will be initially available for return to rate payers as a result of this change as well as $1.6 million per year of additional ratepayer benefits on an ongoing basis beginning in 2020. As stated in the application, these estimates include gross-up for federal taxes.
- For state income taxes, the Company estimates a tax benefit of approximately $1.3 million annually, for the period January 15, 2021, until the effective date of the Company's next general rate case.

Reason for Deferral
Avista's application requests authorization of this deferral in order to appropriately match the costs borne by and benefits received by customers.

*Information Related to Future Amortization*

- Earnings Review – Prior to amortization, an annual earnings review will be conducted pursuant to ORS 757.259(5).
- Prudence Review – Prior to amortization, a prudence review will be conducted. The prudence review should include verification of the actual tax benefits to determine the amortization balance.
- Sharing – This deferral is not subject to a sharing mechanism.
- Rate Spread/Design – Applicable benefits will be allocated to the appropriate customer classes.
- Three Percent Test (ORS 757.259(6)) – The three percent test measures the annual overall average effect on customer rates resulting from deferral amortizations. The three percent test limits (with exceptions) the aggregated deferral amortizations during a 12-month period to no more than three percent of the utility's gross revenues for the preceding year.

<u>Conclusion</u>

For the reasons state above, Staff concludes that approval of the deferral and accounting order will benefit Oregon ratepayers and that the proposed change in accounting method is consistent with the requirements of Oregon law regarding deferrals.

## PROPOSED COMMISSION MOTION:

Approve Avista's Application for Authorization to Approve Federal Income Tax Expense for Certain Plant Basis Adjustments Changes, effective May 5, 2021. Approve Avista's Application to Defer Associated Changes in Tax Expense, with the clarifications in Avista's supplemental filing, for the twelve-month period beginning October 30, 2020.