

1                               **BEFORE THE PUBLIC UTILITY COMMISSION**  
2                                               **OF OREGON**

3                                               AR 499

4       In the Matter of                               )  
5                                                               )   STAFF'S OPENING COMMENTS  
6       Adoption of Permanent Rules to Implement   )  
7       SB 408 Relating to Utility Taxes.           )

8                                               **INTRODUCTION**

9               On July 14, 2006, the Public Utility Commission of Oregon ("Commission") entered an  
10      interim order that provided proposed rules on the calculation of properly attributed. On July 21,  
11      2006, a workshop was held and the participants discussed the interim order and proposed rules.  
12      On July 25, 2006, Staff filed draft rules based upon the interim order and comments from the  
13      workshop. Along with the draft rules, Staff filed a list of issues that it planned to address in  
14      these comments. Staff takes this opportunity to address those issues, including related changes  
15      to the draft rules.

16                                               **COMMENTS**

- 17               1. Whether the calculation of properly attributed federal and state income taxes should be  
18               based on factors (e.g., property and payroll) solely in Oregon or in all jurisdictions in  
19               which the utility has regulated operations.

20               At the last workshop, many parties expressed concern that Oregon-only figures would  
21      result in a mismatch between taxes paid and taxes collected, because the latter reflects allocation  
22      of multi-state property and payroll. The Commission, in determining the calculation of properly  
23      attributed, has the discretion to adopt a variation of the method in the interim order that would  
24      more closely reflect the costs of property and payroll on which customer rates are based. While  
25      the interim order suggests that Oregon-only figures should be used, Staff understands the

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1 concerns expressed at the last workshop and would support a variation of the method described  
2 in the interim order that would consider a better match between taxes paid and taxes collected.

3 Specifically for federal income taxes, the three-factor approach would be used to  
4 apportion taxes paid to the regulated operations of the utility. Then, the utility's Commission-  
5 authorized multi-state allocation factor (income before taxes) would be used to determine the  
6 amount attributed to the regulated operations of the utility in Oregon.

7 State taxes would be calculated in one of two ways, depending on what state taxes the  
8 Commission recognizes in setting rates:

9 (1) For a utility whose rates in Oregon are calculated including the effect of  
10 income taxes in other (non-Oregon) states, the three-factor approach would be  
11 used for each state to apportion taxes paid to the utility's regulated operations  
12 on a system-wide basis. The total amount of state taxes paid would then be  
multiplied by the multi-state allocation factor to calculate the amount  
properly attributed to Oregon regulated operations.

13 (2) For a utility whose rates incorporate state taxes in Oregon only, the  
14 calculation is simply the total amount of Oregon income taxes paid multiplied  
15 by the average of the property, payroll and sales ratios, except that the  
16 amounts for Oregon regulated operations would reflect allocated property and  
payroll (consistent with how rates are set) rather than Oregon situs figures.

17 The changes to the draft rules that would recognize the multi-jurisdictional nature of the  
18 three factor approach are shown in section (3) of the rule (*See Attachment A*).

- 19 2. Whether the calculation of properly attributed state income taxes should be based on all  
20 companies within the affiliated group in the state or only those companies in the utility's  
21 unitary group.

22 In determining the amount of taxes paid that are properly attributed to regulated  
23 operations of the utility, ORS 757.268(6)(b) requires the Commission to begin with the amount  
24 that "the affiliated group pays to units of government. . ." The Department of Justice Opinion  
25 gives the Commission broad discretion in calculating the properly attributed amount, including a  
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determination that taxes paid by certain corporations within the affiliated group are unrelated to the utility's properly attributed amount.

Therefore, the Commission could determine that state income taxes properly attributed to the regulated operations of the utility should be determined as a share of those corporations of the affiliated group with which the utility has a nexus, as implicitly defined by the unitary group that includes the utility. Calculating state taxes using the unitary group is appropriate because it recognizes the group of corporations that underlies the tax filing, in the same manner that the affiliated group is used for the federal tax filing. Under this approach, the three-factor approach would be calculated using the amount of state income taxes paid by the utility's unitary group (equivalent to the total amount the affiliated group pays minus the taxes paid by companies outside the utility's unitary group). The factors would be calculated using the Oregon amounts for the utility's unitary group in the denominator rather than all the taxpayer's corporations in Oregon.

See Attachment A, subsections (3)(b), (3)(c) and (3)(d) for the related changes to the rules.

3. How the calculation of properly attributed local income taxes should be performed.

Currently, the only local income tax applicable to the four utilities subject to SB 408 is the Multnomah County Business Income Tax ("MCBIT"). This amount of the tax is determined by allocating the taxpayer's Oregon state income taxable income liability according to gross income generated in Multnomah County. Because the starting point for MCBIT is the state tax liability, if the unitary group is used for calculating the factors in the state tax calculation, the unitary group also should be used in the local tax calculation.

In addition, the amount of local tax paid could be allocated to the utility's regulated operations on the basis of gross income generated in Multnomah County (as a percentage of the total gross income of the affiliated group in Multnomah County). This approach would use only

1 a single factor—gross income—but it would be consistent with the allocation method used by the  
2 County itself to apportion taxable income.

3 *See* Attachment A, subsection (3)(d) for the related changes to the rules.

4 4. How the calculation of the “with and without” 12(a) cap should be performed.

5 The participants in the last workshop raised questions regarding the calculation of the  
6 “with and without method,” including whether, at the state level, the calculation should be done  
7 for the utility’s unitary group or for all the corporations of the affiliated group. Staff believes an  
8 additional question that must be answered is whether the calculation should be done for all  
9 jurisdictions in which the utility has regulated operations if the Commission recognizes such  
10 taxes in setting rates for Oregon customers.

11 Staff believes that the “with and without” calculation should be done using all  
12 corporations that are included in the group that the utility has included for filing the particular  
13 return. For federal taxes, this likely includes all members of the consolidated group. For state  
14 and local taxes, it is probably a unitary group. Further, for a utility whose rates are based on  
15 multi-state income taxes, the calculation should be done for all states, with the total then  
16 allocated to Oregon operations in the same manner as the properly attributed calculation (*See*  
17 Section (3)(a)). If all the state taxes in all jurisdictions were not considered, it would create a  
18 mismatch between taxes paid and taxes collected.

19 *See* Attachment A, subsection (4)(b) and (4)(g) for the related changes to the rules.

20 5. How deferred taxes for non-Oregon regulated operations within the affiliated group  
21 should be treated, in order to ensure compliance with normalization requirements of  
22 federal tax law.

23 Staff believes that paragraph (2)(o)(C) of the rule, which requires an adjustment for  
24 deferred taxes related to the regulated operations of the utility, will adjust deferred taxes for the  
25 utility subject to Oregon regulation so that there is no risk of a normalization violation related to  
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1 the utility's deferred taxes. In practice, this adjustment could consist of "adding back" the  
2 utility's deferred taxes on an Oregon allocated basis.

3 It remains unclear whether there is a risk of a normalization violation related to deferred  
4 taxes from other regulated operations of the affiliated group. A potential violation might be  
5 created by allocating the taxes paid amounts in the properly attributed calculation to regulated  
6 operations in Oregon—amounts from tax returns that could include the effect of accelerated  
7 depreciation in other regulated operations of the group.

8 In order to avoid a potential normalization violation from effectively passing through to  
9 Oregon customers a portion of accelerated depreciation benefits of other regulated operations,  
10 staff recommends adding language under subsection (2)(o) that would allow another adjustment  
11 to "Taxes Paid" if warranted.

12 All adjustments to Taxes Paid identified in subsection (2)(o) would be made, if  
13 applicable, as specified in subsections (4)(e) and (4)(j), before calculating the difference between  
14 Taxes Paid and Taxes Collected. As an example, state tax credits under 2(o)(B) would be  
15 ignored for purposes of adjusting the amount of federal and local income taxes paid.

16 See Attachment A, subsection (2)(o)(D) for the related changes to the rules.

17 DATED this 31<sup>st</sup> day of July 2006.

18 Respectfully submitted,

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20 HARDY MYERS  
Attorney General

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23 Jason W. Jones, #00059  
24 Assistant Attorney General  
Of Attorneys for Public Utility Commission of  
25 Oregon Staff  
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**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" means the group of corporations of which the utility is a member and that files a consolidated federal income tax return.

(b) "Deferred taxes" for purposes of the utility means the total deferred tax expense of regulated operations as reported in the FERC deferred tax expense accounts that relate to the year being reported in the utility's results of operations report or tax returns.

(c) "FERC" means the Federal Energy Regulatory Commission.

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

(e) "Investment" means capital outlays for utility property used to provide regulated service to customers.

(f) "Local taxes collected" means the total amount collected 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 Oregon regulated operations as calculated in section (3) of this rule.

(i) "Regulated operations of the utility" means those activities of a utility that are subject to rate regulation by the Commission.

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

(k) "Revenue" means retail revenues from ratepayers in Oregon as defined by FERC, excluding other operating revenues as defined by FERC and supplemental schedules not included in the utility's revenue requirement and adjusted for any rate adjustment imposed under this rule.

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

(m) "Tax" means a federal, state or local tax or fee that is imposed on or measured by income and that is paid to a unit of government, but does not include a franchise fee or privilege tax.

(n) "Taxes authorized to be collected in rates" means the following for federal and state income taxes:

(A) The amount calculated by multiplying the following three values:

(i) The revenue the utility collects, using information from 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)(m)(A), when the Commission has authorized a change during the tax year for gross revenues, net revenues or effective tax rate, the amount will be calculated using a weighted average of months in effect.

(o) "Taxes paid" means net amounts received by units of government from the utility or from the affiliated group and properly attributed to regulated operations of the 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 utility;

(B) Increased by the amount of tax credits on the tax return that are associated with investment by the utility in the regulated operations of the utility, which may include, but are not limited to, tax credits associated with renewable electricity production, 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 utility's most recent general ratemaking proceeding; ~~and~~

(C) Adjusted by deferred taxes related to the regulated operations of the utility. The utility must initially use its results of operations report to establish the amount of deferred taxes. If the utility does not believe that the results of operations report sufficiently reflects the amount of the utility's deferred taxes for the applicable tax year, the utility may also use its tax returns for the tax year as a supplemental source for calculating the deferred taxes adjustment as a

separate submission. Deferred taxes do not include deferred tax items related to an adjustment under section (9) of this rule; ~~and~~

(D) Adjusted by deferred taxes related to other regulatory operations of the affiliated group to the extent the related tax effects have been included in the calculation of Taxes Paid in subsections (4)(a) through (4)(c) and (4)(f) through (4)(h).

(p) "Taxpayer" means the utility or the affiliated group that files income tax returns with units of government.

(q) "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.

~~(r)~~ "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 a utility is the product of the following ~~two~~ three figures:

(A) The total amount of federal income taxes paid by the taxpayer; ~~and~~

(B) The average of the ratios calculated for the utility's property, payroll and sales, as defined in ORS 314.650 through 314.675, using amounts for regulated operations of the utility in ~~Oregon~~ all jurisdictions in the numerator and amounts for the taxpayer in the denominator; ~~and~~

(C) The ratio calculated as the utility's income from regulated operations in Oregon divided by the income of the regulated operations of the utility in all jurisdictions.

(b) For a utility that the Commission, in establishing rates, recognizes non-Oregon state income taxes, t~~The~~ amount of state income taxes paid to units of government that is properly attributed to the regulated operations of a utility is ~~the product of the following two figures~~ calculated as follows:

~~(A) The total amount of Oregon income taxes that is paid by the taxpayer; and~~

~~(AB)~~ The total amount of state income tax paid by the unitary group in each state where such state income tax is recognized by the Commission in establishing rates is multiplied by the average of the ratios calculated for the utility's property, payroll and sales, as defined in ORS 314.650 through 314.675, using amounts for regulated operations of the utility in the state ~~Oregon~~ in the numerator and amounts in the state for the ~~taxpayer~~ unitary group in Oregon in the denominator.



(B) The sum of the amounts calculated in paragraph (3)(b)(A) will be multiplied by the ratio calculated as the utility's income from regulated operations in Oregon divided by the income of the regulated operations of the utility in all jurisdictions.

(c) For a utility that the Commission, in establishing rates, recognizes state income tax of Oregon only, the amount of state income taxes paid to units of government that is properly attributed to the regulated operations of a utility is the product of the following two figures:

(A) The total amount of Oregon income taxes that is paid by the unitary group; and

(B) The average of the ratios calculated for the utility's property, payroll and sales, as defined in ORS 314.650 through 314.675, using allocated amounts for regulated operations of the utility in the numerator and the sum of allocated amounts for regulated operations of the utility and the amounts in the state for the other corporations of the unitary group in the denominator.

(de) 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 following two figures for each local taxing authority in Oregon:

(A) The total amount of income taxes paid by the unitary group taxpayer to the local taxing authority; and

(B) The ~~average of the ratios~~ calculated ~~as for~~ the utility's gross income from property, payroll and sales, as defined in ORS 314.650 through 314.675, using amounts for regulated operations ~~of the utility~~ in the local taxing authority divided by the gross income of in the numerator and amounts for the unitary group taxpayer in the local taxing authority ~~in the denominator.~~

(4) By October 15 of each year, each utility must file a tax report with the Commission. The tax report must contain the following 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;

(b) The amount of the federal and state income taxes paid that is incurred as a result of income generated by the Oregon regulated operations of the utility, calculated as the difference between the taxpayer's tax liability computed with and without the regulated operations of the utility, and using the group of corporations included in the consolidated tax returns filed with each federal and state taxing authority that the Commission recognizes in setting rates. For a utility that the Commission, in setting rates, recognizes non-Oregon state income taxes, the total amount of state income taxes paid under this subsection is allocated to regulated operations in Oregon according to the ratio established in paragraph (3)(a)(c);

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

(d) The amount of federal and state income taxes authorized to be collected in rates for the Oregon regulated operations of the utility;

(e) The amount of the difference between the amount in subsection (4)(d) of this rule and the lowest of the amounts in subsections (4)(a), (4)(b) and (4)(c), after making the adjustments defined in subsection (2)(o) of this rule, if applicable;

(f) The amount of local income taxes paid to units of government by the taxpayer, by local taxing authority;

(g) 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 Oregon operations of the utility, calculated as the difference between the taxpayer's tax liability computed with and without the regulated operations of the utility, and using the group of corporations included in the consolidated tax return, by local taxing authority;

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

(i) The amount of local income taxes collected from Oregon customers, by local taxing authority;

(j) The amount of the difference between the amount in subsection (4)(i) of this rule and the lowest of the amounts in subsections (4)(f), (4)(g) and (4)(h), after making the adjustments defined in subsection (2)(o) of this rule, if applicable, by local taxing authority; and

(k) 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)(e) and (4)(j) of this rule.

(5) In calculating the amount of taxes paid under section (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 each tax liability shown on an initial or amended tax return for the immediately preceding tax year, which return is filed on or before the date the tax report is due for such tax year, 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, to the tax year in which the related tax liability or tax adjustment 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 taxes paid amount will reflect a weighted average of the months in effect related to each 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. Each utility must obtain and provide any information requested by the Commission to implement and administer this rule.

(7) The Commission will establish an ongoing docket for each of the October 15<sup>th</sup> tax report filings. If a petitioner is granted intervention and becomes a party to the docket, they may have access to all such tax report filings at the time the tax report filings are filed with the Commission, subject to the terms of any protective order issued.

(a) Within 20 days following the October 15 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 making the findings in section 8 of this rule.

(8) The Commission's order in subsection 7(b) of this rule will contain 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 are properly attributed to the Oregon 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 Oregon 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 Oregon regulated operations of the utility and the amount of local taxes collected in rates; and

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

(9) Upon entry of an order finding a difference of \$100,000 or more in section (8) of this rule, the utility must file an amendment to its automatic adjustment clause tariff to be effective each June 1, unless otherwise authorized by the Commission. The amended tariff must 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 subsection (8)(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 subsection (8)(c) of this rule.

(c) Any rate adjustment must be calculated to amortize the difference determined by the Commission in subsections (8)(b) and (8)(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 January 1 of the year following 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) By October 15, 2006, each utility must seek a Private Letter Ruling from the Internal Revenue Service on whether the utility's compliance with Senate Bill 408, this rule, or any other relevant guidance or authorities would cause the utility to fail to comply with federal normalization requirements or other requirements of federal tax law. 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 (9)(e) of this rule on the amount of any rate adjustment determined by the Commission pursuant to subsections (8)(b) and (8)(c) of this rule.

(10) No later than 30 days following the Commission's findings in section (8) of this rule, any person may file 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 decides against termination, interest will accrue according to subsection (9)(e) of this rule on the final amount of the rate adjustment. The person filing the claim will bear the burden of proof to substantiate the claim.

(11) 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. The utility filing the claim will bear the burden of proof to substantiate the claim.

(12) The Commission may disclose, or any intervenor in a utility tax report proceeding may obtain and disclose, the amount by which the amount of taxes that units of government received from the utility or from the affiliated group differs 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. The Commission will not disclose or authorize disclosure of any information that is exempt from disclosure under the Public Records Law (ORS 192.410-192.505).

Stat. Auth.: ORS Ch. 183, 756, 757 & 759

Stats. Implemented: ORS 756.040, 756.060, 757.267 & 757.268

[Hist.: PUC 5-2005(Temp), f. & cert. ef. 9-15-05 thru 3-13-06]

AR 499 permanent rule final draft.doc

**CERTIFICATE OF SERVICE**

I certify that on July 31, 2006, I served the foregoing upon the parties in this proceeding hereto by electronic mail and sending a true, exact and full copy by regular mail, postage prepaid or by shuttle mail/hand deliver to the parties accepting paper service.

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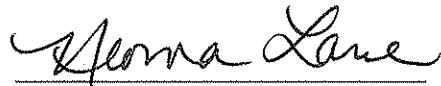
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