# SENATE BILL 408, TAX FILINGS
# STAFF'S INITIAL FINDINGS
# FOR PACIFICORP – UE 177

**TO:** ALL PARTIES
DOCKET NO. UE 177(1)
**PACIFICORP**
**SB 408 TAX FILINGS – UE177(1)**
**2006 TAX PERIOD**

**FROM:** DUSTIN BALL, SENIOR UTILITY ANALYST,
CARLA OWINGS, SENIOR UTILITY ANALYST,
PUBLIC UTILITY COMMISSION

**DATE:** DECEMBER 19, 2007

**CC:** LEE SPARLING, ED BUSCH, JUDY JOHNSON AND JASON JONES

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On October 15, 2007, PacifiCorp (PPL or Company) filed UE 177, its tax report covering the 2006 calendar year pursuant to Senate Bill 408 (SB 408) (codified at ORS 757.267, 757.268 and OAR 860-022-0041).

Much of the information contained in these reports represents highly confidential and sensitive information. Staff has structured its initial findings in this report in a generic manner in order to avoid the possibility of disclosing confidential or sensitive information.

Staff thoroughly reviewed each calculation and all documentation provided by the Company.

PPL reports the following for its Oregon Regulated Operations for the 2006 Tax period:

| Taxes Paid and Properly Attributed to Regulated Operations | Taxes Authorized to be Collected in Rates | Difference between Taxes Paid and Collected Surcharge or (Refund) |
|---|---|---|
| **$87.0 million** | **$54.4 million** | **$32.6 million** |

***Staff and the Company have discussed the issues outlined in this document. Staff has requested that Company file a revised version of the Staff Template no later than January 2, 2008*, *and compliant with the Staff recommendations in this document.*** Having a revised version filed by this date will allow Staff a short period of time to review the revisions prior to Settlement Conferences which are currently scheduled for the week of January 7, 2008. While Staff raises numerous issues in this document, it reserves the opportunity to raise new issues during the time remaining in this proceeding.

Prior to March 21, 2006, PPL was owned by Scottish Power which operated based on a fiscal year beginning April 1 of each year and ending March 31st. On March 21, 2006, PPL was acquired by MidAmerican Energy Holdings Company, a subsidiary of Berkshire Hathaway, Inc. that operates on a calendar year basis and files its income tax returns as such. Since the acquisition took place in March of 2006, PPL was required to file two separate tax returns; one with Scottich Power for the fiscal year ending March 21, 2006 and one with Berkshire Hathaway, Inc., for the calendar year ending December 31, 2006.
OAR 860-022-0041(5)(a)(A) requires the Company to reflect the weighted average of months in effect related to each tax period. For purposes of this tax filing, PPL has assigned a 25.0% weighting factor to the Scottish Power tax filing and a 75.0% weighting factor to the Berkshire Hathaway Inc tax filing.

Following is a detailed summary of Staff's review:

Staff requested the Company provide further clarification related to the following items:

- provide detailed information showing how PPL fit into the Berkshire Hathaway Inc, & Subsidiaries federal and state tax returns;

- provide work papers reconciling depreciation amounts of public utility property to the tax return;

- justify the source of information for reporting federal taxpayer sales amounts used as an allocation factor;
- provide work papers supporting the amounts reported as wages & salaries for Oregon Regulated Operations and System Regulated Operations;
- clarify the amount of iterative effect reported;
- provide a breakout of deferred taxes;
- justify deferred tax only adjustments not directly related to temporary Schedule M items;
- clarify the Federal Investment Tax and Renewable Tax credits;
- clarify and justify the method for calculating the Stand-alone tax liability;
- provide work papers showing the calculation of the interest expense for the Stand-alone tax calculations;
- justify the exclusion of local tax flow through effects on various calculations;
- justify the inclusion of AFUDC interest and dividend income in the Stand-alone calculation; and
- clarify the calculation of deferred taxes.

As a result of our review, Staff recommends the following changes to PPL's original filing:

## 1. Redaction of Information:

Staff Comment:

In reviewing the supporting work papers provided by PPL, Staff encountered substantial redactions to the tax returns for both Scottish Power and Berkshire Hathaway Inc. Through data requests, Staff requested unredacted copies of this information. However, PPL objected and stated that it would only provide specific unredacted information if Staff were to demonstrate a specific need for such information. Staff did not persist on obtaining unredacted copies of Scottish Power or Berkshire Hathaway, Inc's tax records, because the Stand-alone method produced a lower amount of taxes paid and was ultimately the method relied upon for the outcome of PPL's filing.

Further, Staff believes it is unnecessary for PPL to file its SB 408 filing under a modified protective order claiming "highly confidential" information and then submit redacted information that hinders Staff's ability to perform a timely review. Staff has modified its procedures to accommodate the highly confidential and sensitive information.

***Staff recommendation:***

***For the 2007 tax period filing, Staff recommends that PPL file unredacted work papers, as the SB 408 filing process is treated under a modified protective order as "highly confidential".***

## 2. Consolidated Apportionment Ratios:

Staff Comment:

On Page 2a of the Staff Template, lines 6, 7, and 8, PPL reported the federal taxpayer amount of gross plant, wages/salaries, and sales/other receipts (two of the three apportionment factors requested in this part of the template). In doing so, PPL reported the amounts shown on the Oregon Schedule AP in the "total within and without Oregon" column. However, in reporting the federal taxpayer amount of sales/other receipts, the company did not use the amount shown on the Oregon Schedule AP, but rather calculated the percentage of the previous year's sales/receipts as a portion of gross income. As a result of this calculation, the outcome of the ratio applied to the taxes paid was increased.

The Company explained that the rational for this calculation was that during the 2006 tax year one of their affiliates changed its method of reporting sales, which substantially increased the amount shown on the Oregon Schedule AP. According to PPL, by applying the previous year's sales/receipts as a portion of gross income to the previous year, they effectively eliminated the change to the method of reporting sales of their affiliate during the year.

Staff believes that because the tax liability reported on the Company's Oregon Schedule AP is based on the same ratios being requested in the Staff Template, the Company should use this source of information to perform the calculation in the Staff Template. Staff also believes that this will create consistent methodology amoung all the companies required to file the SB 408 filings.

Staff is not recommending that the Company change the current year's filing related to this item, because the change will not impact the overall outcome of the filing. Staff also believes that this may be a one-time occurrence as PPL will no longer be affiliated with Scottish Power.

***Staff recommendation:***

***For the 2007 tax period filing, Staff recommends that PPL use the amounts reported as the "total within and without Oregon" as the federal taxpayer amounts on Staff Template lines 6, 7, and 8, in order to create consistency in the SB 408 filings.***

**3. Interest Calculation for the Stand-Alone Calculation:**

Staff Comment:

OAR 860-022-0041(2)(p) reads as follows:

> "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."

For purposes of computing their Stand-alone tax liability, PPL applied the actual unadjusted Oregon interest expense as taken from their results of operations reports rather than calculating an interest expense in the manner used by the Commission in establishing rates (rate base * weighted cost of debt).

This adjustment will decrease the interest expense for purposes of calculating the Stand-alone tax liability, and in turn, increase the overall taxes paid amount.

***Staff recommendation:***

***Staff recommends that PPL recalculate their Stand-alone tax liability by calculating interest expense in the manner used by the Commission in establishing rates (rate base * weighted cost of debt).***

## 4. Deferred Tax Only Adjustments:

Staff Comment:

The deferred tax amounts reported by PPL not only include deferred taxes related to temporary Schedule M (book-tax differences) items, but also include substantial "deferred tax only adjustments". PPL explained that the deferred tax-only adjustments are related to flow-through depreciation from pre-1981 assets. The Company has increased the deferred taxes in order to incorporate the tax benefits of accelerated depreciation that, pre-1981, were passed through to ratepayers. Staff is uncertain whether this is the appropriate method to account for this flow-through adjustment. Prior to making a recommendation, Staff would like to further discuss this issue with the Company in order to fully understand the adjustment. Additionally, Staff has an outstanding data request pertaining to this question, which, at the time of this writing, a response has not yet been submitted by the Company.

## 5. Deferred Taxes Applied at the Book Amount Rather than Actual Amount:

Staff Comment:

To apply the deferred tax amounts reported on page 6 of Staff's Template, PPL applied the blended statutory rate at which they book their deferred tax items. This rate is reviewed annually and adjusted if needed.

Staff disagrees with the Company's method of determine the deferred tax amount for the purpose of this filing because it omits the ramification of the actual determinants at the time of the tax filing. Using a blended statutory rate does not reflect the actual, current tax benefit. Staff believes that the deferred tax amount should reflect the current tax benefit/ramification of the determinant at the time of the tax filing.

***Staff recommendation:***

***Staff recommends that PPL recalculate their deferred taxes using the actual effective tax rates (local, state, and federal) as shown in the actual 2006 tax filings***.

## 6. Oregon Stand-Alone State Tax Allocation Ratio:

Staff Comment:

Pursuant to OAR 860-022-0041(3)(d)(B)(i), for utilities with non-Oregon income taxes included in rates, the sum of all state Stand-alone tax liabilities are apportioned to Oregon at the ratio of taxable income of Oregon regulated operations, as compared to taxable income of System regulated operations. PPL has computed this ratio based on the Stand-alone taxable income for the respective regulated operations which includes a deduction for depreciation.

Staff disagrees with this method of computing the Stand-alone ratio, as the administrative rules specifically state that there should be no depreciation deduction for the Stand-alone[1] calculation.

***Staff recommendation:***

***Staff recommends that PPL recalculate the state Stand-alone tax liability apportionment ratios based on Stand-alone taxable income which does not include a deduction for depreciation.***

## 7. Current Tax Benefit of Depreciation:

Staff Comment:

The depreciation deduction on page 6, lines 6, 15, and 24 of Staff's Template is a reflection of the current tax benefit of depreciation of public utility property of the Oregon regulated operations. In response to Staff's Data Request No. 30, PPL proposed a revision to increase the original amount reported as the tax benefit of depreciation. This proposal would reduce the overall taxes paid by PPL. Staff would like to further consider this issue and discuss this item with PPL prior to making a recommendation.

## Generic issues:

The following is a description of generic issues regarding all of the filings.

***Generic Issue 1) Modifications to the Staff Template***

In its review, Staff recommends modifications to the Staff Template in order to facilitate more consistency in the Company filings.

a. Add a column to the Staff Template between the Line No. Column and the boxes used to report dollar amounts so that the Company can input

[1] OAR 860-022-0041(2)(p)

a reference to the source document related to the dollar amount in the associated box.

b. Add a blank header line to the Staff Template that will allow the Company to add the Company name so each page of the template will contain the Company name.

c. Add a worksheet to the Staff Template packet that contains a format for the Stand-alone calculation in order to create consistency as to how the Stand-alone calculation should be done and the source information that should be used to calculate Stand-alone.

d. Each Company should provide an electronic version on a CD of the Staff Template in order to facilitate the review of calculations.

**_Generic Issue 2)_ Calculation of Stand-alone Utility.**

Staff Comments:

Pursuant to OAR 860-022-0041(2)(p), the Utility's Stand-alone calculation means the amount of income tax liability calculated using a *pro forma*[2] tax return and revenues and expenses in the Utility's results of operations report for the year, except using zero depreciation expense for the pubic utility property, excluding any tax effects from the investment tax credits, and calculating interest expense in the manner used by the Commission in establishing rates.

Staff found that the utility companies interpret this calculation differently. One company used the actual tax liability from the consolidated tax return and applied the *actual* Schedule M adjustments (rather than the estimated amounts that would be used to prepare its results of operations report) in order to derive a pre-tax income from the results of operations. The Company then reported this amount as tax liability for the Stand-alone calculation.

Another Company used the Revenues and Expenses reported in the results of operations report, applied *estimated* Schedule M adjustments (as used in the results of operations report) and used the interest synchronization method as an interest expense pursuant to the method described in the rule above.

Yet another Company used the revenues and expenses from the results of operations report and calculated interest as directed in the rules, but did not apply *any* Schedule M adjustments (the current rules do not direct the Utility to apply Schedule M's).

[2] Emphasis added.

***Staff believes that the rules as they currently written are unclear and that they do provide an accurate proxy for the calculation of Stand-Alone Utility Tax Liability.***

The results of operations report is a proforma regulatory report that requires that the Company use Annual Average amounts rather than the actual End-of-Period amount. For an actual Tax Return, the Company would be required to use actual revenues and expenses on a cash basis (not accrued). To accomplish this, the Company applies Schedule M adjustments on a permanent and temporary basis. These adjustments simply bring the Company from a "book" basis to a cash basis. The appropriate interest deduction is accounted for when the actual Schedule M adjustments are applied to the cash basis of revenues and expenses, making it unnecessary to calculate interest using the Company's weighted cost of debt and annual average rate base.

The rules, as written, create an inaccurate view of the Utility's Stand-alone tax liability by requiring the Company to use annual average amounts and interest synchronization without consideration of the application of Schedule M's, whether estimated or actual. Additionally, as the rules currently exist, there is no direction as to all the functions that should be required in order to perform the Stand-alone calculation.

Staff believes the Stand-alone Utility calculation should use revenues and expenses on a cash basis, apply actual Schedule M adjustments, appropriately deduct all interest associated with its actual debt (not a proxy for debt) and other allowable interest expenses, and then apply Tax Credits that may, or may not be, available to the Utility on a Consolidated basis.

***Staff recommendation:***

***Staff suggests a housekeeping change to this section of the rule to revise the "Stand-alone" calculation in order to develop a method to perform this calculation more consistently to what a pro forma tax return would look like for a Stand-alone Utility. Staff will make a recommendation in the rulemaking, which is expected next spring.***

# CERTIFICATE OF SERVICE

## UE 177

I certify that I have this day served the foregoing document upon all parties of record in this proceeding by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-13-0070, to the following parties or attorneys of parties.

Dated at Salem, Oregon, this 19th day of December, 2007.

Kay Barnes

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# UE 177
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