SENATE BILL 408, TAX FILINGS
STAFF'S INITIAL FINDINGS
FOR NORTHWEST NATURAL GAS COMPANY – UG 170

TO: ALL PARTIES
DOCKET NO. UG 170(1)
NORTHWEST NATURAL
SB 408 TAX FILINGS – UG 170(1)
2006 TAX PERIOD

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

DATE: DECEMBER 20, 2007

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

On October 15, 2007, Portland General Electric (PGE or Company) filed UE 178(1), 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 tax 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 has thoroughly reviewed each calculation and all documentation provided by the Company.

NW Natural reports the following for its Oregon Regulated Operations during 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)
$32.2 million	**$30.5 million**	**$1.7 million**

Staff conducted interviews with the Company, sent 17 Data Requests, met face-to-face with the Company in mid November, and conducted several phone interviews.

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.

Following is a detailed summary of Staff's review:

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

- provide documentation for the calculation of the current tax benefit of depreciation on all public utility property;
- provide documentation for amounts reported as Total Gross Plant, and Total Wages & Salaries for Oregon Regulated Operations;
- provide a work papers showing the calculation of the Stand-alone federal, state, and local tax liabilities;
- provide a breakdown of the interest calculation, including the capital structure and weighted cost of debt used, for the pro forma Stand-alone tax calculations;
- clarify the imputed negative tax losses in the federal taxpayer group during 2006;

- identify the individual amounts reported as state income taxes paid by the unitary group;

- justify the method of reporting deferred taxes, tax credits, and the tax benefit of depreciation;

- justify the exclusion of local tax flow through effects on various calculations;

- clarify the application of Schedule M's that were applied in the Stand-alone calculation; and

- identify the effect of the tax benefit on federal investment tax credits for purposes of the Stand-alone calculations.

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

1. Workpapers:

Staff Comment:

Although NW Natural submitted work papers with the original filing, documentation of calculations that appear in the Staff template would have greatly facilitated the review and likely would have narrowed the number of Data Requests and phone calls to the Company.

Staff recommendation:

For the 2007 tax filing, Staff recommends the Company provide all work papers used in the 2006 filing as well as the work papers submitted in response to Staff's Data Requests.

2. Stand-alone Calculation:

Staff Comment:

In response to Staff's data requests, NW Natural submitted a spreadsheet detailing the Stand-alone calculation which detailed the process used to derive the federal and state Stand-alone tax liabilities of the Oregon regulated operations as reported on pages 2 and 3 of Staff Template.

Staff thoroughly reviewed this spreadsheet and determined that NW Natural had not considered an interest expense or its temporary Schedule M adjustments. After discussions with the Company, Staff obtained a revised

Stand-alone calculation that included the interest deduction and adjustments for temporary Schedule M items.

In the revised calculation, the interest deduction and temporary Schedule M items had opposite effects on the Stand-alone taxable income and were extremely close to offsetting each other. Staff was able to verify these offsetting items, and as a result, there was no impact to the Stand-alone tax calculation.

3. Underpayment of Estimated Tax:

Staff Comment:

Upon initial review, Staff was unable to verify the Oregon State income taxes paid by the unitary group, as reported in page 3, line 1, of the Staff Template. However, in discussions with NW Natural, Staff learned that the Company had incurred interest on the underpayment of estimated tax, and that the Company had added this amount to the actual Oregon state tax liability in deriving the amount it reported.

Staff agrees that the inclusion of the interest on the underpayment of estimated tax should be included on page 3, line 1, of the Staff Template and acknowledges the Company for its attention to the details in its report.

4. Tax Credits included in the Stand-alone Calculation.

Staff Comment:

NW Natural calculated its Stand-alone federal and state tax liabilities based on revenue and expense items taken from the Company's results of operations report. According to the Company's response to Staff's data request, the tax benefit from federal investment tax credits is included in the amounts reported on the Company's results of operations report. However, Staff believes that the Company did not remove the tax effect of the investment tax credits prior to calculating the federal and state tax liabilities Stand-alone tax liability as is required by rule.

Staff recommendation:

Staff recommends that NW Natural remove the tax effect of federal investment tax credits from its Stand-alone taxable income and recalculate the federal and state Stand-alone tax liabilities. Staff believes that this will result in a reduction of the federal and state income taxes paid by the Company.

5. Application of BETC's :

Staff Comment:

In response to Staff's data requests, NWN explained that the amount reported as credits associated with an Oregon BETC and an Oregon Dependent Care Credit reflected on the tax return and the amount reported in the Staff Template on page 5, lines 3 (apportionment method), 12 (Stand-alone method), and 21 (consolidated method) differed by approximately $6,000 due to a last minute correction on the Oregon Tax Return. This correction was inadvertently omitted from the OPUC tax filing.

Additionally, the addition to taxes paid on page 5, of the Staff Template was greatly reduced (due to the above-mention credits) in the Stand-alone calculation compared to the amount reported for the apportionment and consolidated methods. NW Natural believes that since the Oregon BETC was excluded from the Stand-alone tax calculation, it therefore should not be considered in the add back to the Stand-alone tax liability on page 5, of the Staff's Template.

Staff agrees. It would be inappropriate to include this credit in the add back on page 5, line 12, because the Stand-alone tax liability was never reduced by the Oregon BETC. However, because the apportioned tax liability that was brought forward to page 5, line 1 is derived from the apportioned Stand-alone calculation, Staff believes the all credits should be applied prior to the "greater of" test at the bottom of page 3 of the Staff Template.

Staff recommendation:

Staff recommends that NW Natural revise its state Stand-alone tax calculation to include Oregon tax credits associated with Oregon regulated operations and BETC's prior to entering the amount on Page 3, of the Staff Template. Staff believes that this change may change which method ends up being "greater of" method.

Additionally, Staff recommends that the amounts reported on page 5, lines 3, 12, and 21 (tax credits associated with Oregon regulated operations and BETC) be reduced by approximately $6,000 to reflect the actual credits claimed on the Oregon tax return.

6. Local Taxes paid calculation (Page 7):

Staff Comment:

The local tax calculation begins with the adjusted gross income from the Oregon Schedule AP in its calculation for Multnomah County Income Tax. That amount is adjusted to reflect the benefit of local income tax on the State tax return, creating the MC Income Taxable Income (MCIT).

The next step in the calculation of local taxes is to apportion the Taxable Income by using the Gross Revenues generated in that County as the numerator and the Total Gross Income of the Company as the denominator.

The method used to calculate local taxes is influenced by the Taxable Income or loss as reported on the Oregon Schedule AP as well as the Total Gross income used to apportion the taxable income. Therefore, NWN needs to calculate local taxes using all three methods put forth in Staff's Template so an accurate estimate of local taxes can be determined using the Stand-alone, the apportionment and the consolidated methods.

During discussions with Staff, NWN disagreed that three calculations were necessary since the Company does not include these revenues in its preparation of the results of operations report. However, Staff concludes that since the Oregon Taxable Income can vary depending on which Corporate Structure is represented as a Stand-alone, Staff believes that the Company should compute the local taxes based on the three methods.

Staff recommendation:

Staff recommends that that the Company should compute the local taxes based on the three methods.

7. Tax benefit of depreciation on Local Taxes paid calculation (Page 7):

Staff Comment:

NWN did not calculate deferred taxes or a tax benefit related to depreciation of public utility property for Oregon regulated operations as adjustments to the calculation of local taxes paid on page 7, of the Staff Template.

NWN explained that because local taxes are treated as a pass through, and because the rates for collections of the tax are adjusted quarterly, NWN simply compares the collections to the local tax liability. During the review process, NWN has applied for a separate tariff that will track the revenues associated with the collections as well as establishing a balancing account for the annual true-up of local taxes.

While the Company did not compute or adjust for any deferred taxes or the tax effect of depreciation on page 7, Staff contends that these tax effects do exist. By virtue of being based off of State net income, the Multnomah county tax return will receive flow through effects of deferred tax and depreciation in the same manner in which the State tax return receives these benefits from the Federal tax return.

Staff recommendation:

Staff recommends that NW Natural compute the local tax effect of deferred taxes and depreciation.

Generic issues:

Following is a description of generic issues Staff raises regarding the rules in general, followed by the specific issues Staff has identified.

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 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*[1] 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 used this calculation as the outcome of the Stand-alone tax liability.

Another Company used the Revenues and Expenses reported in the results of operations, applied *estimated* Schedule M adjustments (as used in the results of operations report) and then 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 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).

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.

[1] Emphasis added.

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

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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 20th day of December, 2007.

Kay Barnes

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