SENATE BILL 408, TAX FILINGS
STAFF'S INITIAL FINDINGS
FOR AVISTA CORPORATION – UG 171

TO: ALL PARTIES
DOCKET NO. UG 171(1)
AVISTA CORPORATION
SB 408 TAX FILINGS – UG 171
2006 TAX PERIOD

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

DATE: DECEMBER 20, 2007

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

On October 15, 2007, Avista Corporation (Avista) filed UG 171(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.

Avista reports the following for its Oregon Regulated Results of Operations for the 2006 Tax period:

Taxes Paid to units of Government	Taxes Collected	Surcharge or (Refund)
$3.2 million	**$4.3 million**	**($1.1 million)**

Staff conducted interviews with the Company, sent 11 Data Requests, met face-to-face with the Company in late October, 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:

- justify adjustments made to the collection of Revenues;
- provide a break-out of its Oregon wages and salaries and to review the source information and the apportionment factor used to derive the calculation of Oregon wages and salaries;
- provide documentation of the Federal Taxpayer amount used for wages and salaries;
- clarify adjustments made to its Oregon situs property;
- justify the method Avista used to calculate its Oregon Stand-Alone tax liability;
- clarify reclassification entries;
- identify adjustments made to the application of Schedule M's;

- clarify the calculation of deferred Taxes; and
- recalculate its application of Federal and State Tax Credits.

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

1. Work papers:

Staff Comment:

Although Avista 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 period 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. Wages and Salaries:

Staff Comment:

On Page 2 of the Staff template, Lines 7 and 14, Avista provided its Oregon Regulated Operations Wages & Salaries amounts. This amount differed from the amount shown in Avista's Oregon State Income Tax Return, Schedule AP. In response to Data Requests, Staff discovered that the Company had made an adjustment to the Wages & Salaries amount in order to make this amount comparable to the amount shown on the Schedule AP for the Federal Taxpayer. Avista added allocated CWIP to the Oregon portion to make the amount compatible with the Federal number.

Staff agrees that the amounts shown for all apportionment factors should be compatible as possible and that the source for that information should be the Company's Schedule AP. Staff believes that the amounts shown on the Schedule AP should be the source of information for these apportionment to the extent it is possible. Staff believes that the adjustment should take place in a manner that removes CWIP from the Federal Taxpayer rather than to adjust the amount that reflects only Oregon Wages & Salaries.

Staff recommendation:

Staff recommends that Avista revise its 2006 filing to remove CWIP from the Federal Taxpayer portion rather than to add CWIP to the State portion of the Wages & Salaries amounts.

3. State of Oregon Deferred Taxes

Staff Comment:

The deferred tax amounts reported by Avista, on Page 5, of the Staff Template include federal deferred taxes only. In response to Staff's Data Request No. 8, Avista explained that the State of Oregon income taxes are "flowed through" for rate making purposes rather than booked into in the deferred tax amounts.

Staff believes that, by virtue of being based on federal taxable income, the Oregon tax return will receive flow through effects of federal deferred tax items and therefore deferred Oregon income tax should be included on Page 5 of Staffs Template.

Staff recommendation:

Staff recommends that Avista recalculate their deferred taxes to include Oregon deferred taxes.

4. Application of BETC's :

Staff Comment:

Staff' requested documentation for the tax credits associated with Oregon regulated operations and BETCs. In response, Avista demonstrated that the amount reported as credits associated with an Oregon BETC are added back on page 5 of the Staff Template. Staff believes it is 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 in Avista's Stand-alone calculation.

Staff recommendation:

Staff recommends that Avista 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.

5. Schedule M Adjustments Applied to the Stand-Alone Calculation:

Staff Comment:

When applying the Schedule M adjustments to the stand alone tax calculation, Avista applied the estimated book-tax differences related to Oregon regulated operations, rather than the actual differences as of the tax filing. Staff contends that the Avista should apply the actual Schedule M adjustments rather then the estimated amounts.

Staff recommendation:

Staff recommends that Avista recalculate their stand-alone tax liabilities using the actual Schedule M adjustments related to Oregon regulated operations.

6. Deferred Taxes:

Staff Comment:

The deferred tax amounts reported by Avista on Page 5, lines 4, 5, 12, 14, 22, and 23 of the Staff Template are based on the estimated book-tax differences from the results of operations report rather than the actual deferred tax amounts used to prepare the tax filing.

Staff believes that because SB 408 is attempting to compare the actual taxes paid, to the actual taxes collected, the deferred taxes on Page 5 should reflect actual deferred taxes.

Staff recommendation:

Staff recommends that Avista recalculate the deferred tax amounts on Page 6, of the Staff Template, based on the actual book-tax differences as of the tax filings.

7. Deferred Taxes Adjustment for Uncollectibles:

Staff Comment:

Prior to reporting the deferred tax amounts on Page 5 of Staff's Template, Avista made two adjustments. One adjustment was to remove the deferred taxes associated with a SB 408 accrual and the second adjustment was related to an uncollectible expense.

Avista explains that the adjustment associated with Uncollectibles was simply a reclassification of an item that should originally have been attributed to the Oregon Regulated Operations. Staff believes if Avista revises its SB408 filing compliant with Staff issue 6. above, then the reclassification of the uncollectible amount will no longer remain an issue.

Staff recommendation:

Staff recommends that Avista recalculate the deferred tax amounts on Page 6, of the Staff Template, based on the actual book-tax differences as of the tax filings.

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.

<u>Generic Issue 2)</u> **<u>Calculation of Stand-alone Utility.</u>**

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

[1] Emphasis added.

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.

<u>Staff recommendation:</u>

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

UG 171

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

Kay Barnes
Public Utility Commission
Regulatory Operations
550 Capitol St NE Ste 215
Salem, Oregon 97301-2551
Telephone: (503) 378-5763

UG 171
Service List (Parties)

AVISTA UTILITIES RON MCKENZIE MANAGER - REGULATORY ACCOUNTING	 PO BOX 3727 SPOKANE WA 99220-3727 ron.mckenzie@avistacorp.com
CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP EDWARD A FINKLEA **(C)**	 1001 SW 5TH - STE 2000 PORTLAND OR 97204 efinklea@cablehuston.com
CHAD M STOKES **(C)**	1001 SW 5TH - STE 2000 PORTLAND OR 97204 cstokes@cablehuston.com
CITIZENS' UTILITY BOARD OF OREGON LOWREY R BROWN **(C)** **(HC)** UTILITY ANALYST	 610 SW BROADWAY - STE 308 PORTLAND OR 97205 lowrey@oregoncub.org
JASON EISDORFER **(C)** **(HC)** ENERGY PROGRAM DIRECTOR	610 SW BROADWAY STE 308 PORTLAND OR 97205 jason@oregoncub.org
DANIEL W MEEK ATTORNEY AT LAW DANIEL W MEEK **(C)** ATTORNEY AT LAW	 10949 SW 4TH AVE PORTLAND OR 97219 dan@meek.net
DEPARTMENT OF JUSTICE JASON W JONES **(C)** **(HC)** ASSISTANT ATTORNEY GENERAL	 REGULATED UTILITY & BUSINESS SECTION 1162 COURT ST NE SALEM OR 97301-4096 jason.w.jones@state.or.us
KAFOURY & MCDOUGAL LINDA K WILLIAMS **(C)** ATTORNEY AT LAW	 10266 SW LANCASTER RD PORTLAND OR 97219-6305 linda@lindawilliams.net