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February 18, 2011

VIA U.S. MAIL

PUC Filing Center
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

Re: Docket No. UE 177(4)

Enclosed for filing in the captioned docket are an original and five copies of the Joint Testimony of Staff, PacifiCorp, and the Citizens' Utility Board of Oregon (CUB). All three parties join in Part 1 of the testimony; Staff and PacifiCorp join in Part 2. A copy of this filing was served on all parties to this proceeding as indicated on the attached Certificate of Service.

Pursuant to Order No. 06-033, Highly Confidential Exhibit Joint Testimony/202 is being filed under seal in the Portland and Salem Safe Rooms.

Please contact this office with any questions.

Very truly yours,

Katherine McDowell

Enclosure
cc: Service List

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UE 177 (4)

In the Matter of:

PACIFICORP, dba PACIFIC POWER & LIGHT COMPANY

Filing of tariffs establishing automatic adjustment clauses under the terms of SB 408

Joint Testimony of Staff, PacifiCorp, and Citizens' Utility Board of Oregon

Joint Testimony/200

February 2011

Q. Who is sponsoring this testimony?

A. This joint testimony is sponsored Public Utility Commission of Oregon Staff (Staff) and PacifiCorp (PacifiCorp or the Company). The Citizens' Utility Board of Oregon (CUB), is joining Part 1 of this testimony as it continues to support Part 1 of the Joint Stipulation filed on January 11, 2011 in Docket UE 177(4) (Stipulation). However, CUB is not joining Part 2 of this testimony as CUB believes it is unnecessary to file a PLR with the IRS.

Q. Please state your names.

A. Our names are Carla Bird testifying on behalf of Staff, Bob Jenks testifying on behalf of CUB, and Ryan Fuller testifying on behalf of PacifiCorp. Ms. Bird's and Mr. Fuller's qualifications are set forth in Exhibit Joint Testimony/101-102; Mr. Jenks' qualifications are attached as Exhibit Joint Testimony/201.

Q. What is the purpose of your testimony in this proceeding?

A. This testimony addresses the written objections of the Industrial Customers of Northwest Utilities (ICNU) and the testimony of their expert witness Ellen Blumenthal.

Response to ICNU's Testimony on Part 1 of the Stipulation (CUB, Staff and PacifiCorp)

Q. Please summarize your testimony relating to Part 1 of the Stipulation.

A. With respect to Part 1 of the Stipulation, our testimony addresses Ms. Blumenthal's alternative calculation for taxes paid, which forms the basis of ICNU's objection to the $13.5 million surcharge contained in the Stipulation and ICNU's proposal for a large refund. Our testimony shows that ICNU's

calculation: 1) is not compliant with OAR 860-022-0041 or ORS 757.268; 2) violates the normalization requirements of the Internal Revenue Code (IRC) (as shown in Highly Confidential Exhibit Joint Testimony/202); and 3) by using flow-through accounting, creates a significant mismatch when compared to taxes authorized to be collected in rates.

Q. Does ICNU object to Part 1 of the Stipulation on the basis that the Company's 2009 SB 408 tax report is not compliant with OAR 860-022-0041?

A. No. ICNU makes no such objection. In fact, Ms. Blumenthal testifies that the stipulated surcharge in Part 1 is based on the stand-alone method of calculating taxes paid as established in OAR 860-022-0041.[1] In response to PacifiCorp Data Request 1.1, ICNU could not specify any provision of the rule violated by the stand-alone calculation in Part 1 of the Stipulation. See Exhibit Joint Testimony/203.

Q. Part 1 of the Stipulation is conditioned upon the Commission amending OAR 860-022-0041(4)(d) so that the rule does not apply to taxes paid determined under the stand-alone method. Does ICNU agree with Staff's position that the deferred tax floor does not apply to the stand-alone method in the tax report which is the basis for Staff's proposed revision to OAR 860-022-0041 (4)(d)?

A. Yes. Ms. Blumenthal agrees with Staff's position.[2]

Q. On what basis does ICNU object to Part 1 of the Stipulation?

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[1] ICNU/100, Blumenthal 12, Lines 21-22
[2] ICNU/100, Blumenthal/10, lines 1-4

A. ICNU makes no specific objection to any of the terms to Part 1 of the Stipulation. Instead, ICNU proposes an alternative calculation of taxes paid in Highly Confidential Exhibit ICNU/104 (ICNU/104) and recommends a large refund to customers.

Q. Has ICNU proposed rule changes to OAR 860-022-0041 that provide the basis for the alternative calculation of taxes paid in Highly Confidential Exhibit ICNU/104?

A. No. ICNU has proposed no specific rule revisions to OAR 860-022-0041 here or in any other Commission filing. While it is clear that ICNU's alternative calculation is not compliant with OAR-860-022-0041, ICNU has not provided revised rule language that supports its alternative calculation. Neither has ICNU explained procedurally how the Commission can disregard multiple aspects of its current rule in order to approve ICNU's alternative calculation under a different but non-articulated standard, and still ensure that all parties remain protected by the PLR issued by the Internal Revenue Service (IRS) on the current version of OAR 860-022-0041.

Q. What aspects of ICNU's alternative calculation violate OAR 860-022-0041?

A. Because ICNU's alternative calculation is not based on the consolidated tax liability of the taxpayer of which PacifiCorp is a member, the calculation is contrary to OAR 860-022-0041(3). Assuming that ICNU's alternative calculation is designed to calculate stand-alone taxes paid (because it does not address consolidated or apportionment method data), the calculation violates OAR 860-022-0041(2)(p) because: (1) it does not rely upon revenues and expenses from

PacifiCorp's results of operations; and (2) it does not calculate interest using the interest synchronization method. Additionally, contrary to OAR 860-022-0041(2)(b), the calculation does not include all of PacifiCorp's deferred tax expense of its Oregon regulated operations, nor does it include an adjustment for the iterative tax effect.

Q. Is ICNU's alternative calculation compliant with ORS 757.268?

A. No, for similar reasons:

- ICNU's alternative calculation is not based on the **regulated operations** of the utility.[3] The taxable income/(loss) that is the starting point for the calculation in ICNU/104 includes revenues and expenses that are nonutility or would not be included in rates such as unrealized gains and losses (FAS 115), mark-to-market adjustments (FAS 133), charitable contributions, and excludes the activity of Pacific Minerals, Inc. Pacific Minerals, Inc. holds PacifiCorp's two-thirds interest in Bridger Coal Company. Bridger Coal Company constitutes regulated operations, a portion of which fall under the jurisdiction of this Commission. Furthermore, the allocation of the total Company activity to Oregon regulated operations is not based on the Revised Protocol allocation methodology adopted by this Commission, but instead employs an un-adopted, high-level allocation methodology and, therefore, includes activity regulated by the Company's other state jurisdictions.
- ICNU's alternative calculation of taxes paid does not include state income taxes, which is a mismatch because state taxes are included in the taxes

[3] ORS 757.268(6), 757.268(13)(c), ORS 757.268(12)(a)

collected amount ICNU uses. By statutory definition, tax means federal, state, or local tax.[4]

- ICNU's alternative calculation does not include the statutorily required adjustments to taxes paid for charitable contributions made by the Company or for deferred taxes related to the regulated operations of the utility.[5]

Q. Does ICNU directly dispute any of these issues?

A. No. Based upon ICNU's responses to PacifiCorp's First Set of Data Requests, Ms. Blumenthal either points to her calculation in ICNU/104 without explanation (in the case of the exclusion of state taxes and the failure to include an adjustment for iterative tax effect), or acknowledges that she does not know how the issues are treated in her calculation (with respect to the underlying allocation methodology, the exclusion of Pacific Minerals, Inc., the calculation of interest expense and the inclusion of charitable contributions). See Exhibit Joint Testimony/203.

Q. Is the alternative calculation made by Ms. Blumenthal compliant with the normalization requirements of the IRC?

A. No. For the following three reasons, ICNU's alternative calculation is not compliant with normalization requirements of the IRC:

- As noted above, the pre-tax book income and taxable income in ICNU's alternative calculation excludes Pacific Minerals, Inc., a two-thirds owner of Bridger Coal Company. Bridger Coal Company constitutes operations regulated by this Commission and its property is considered public utility property as defined by the normalization rules of the IRC, and accordingly,

[4] ORS 757.268(13)(d)(A)

[5] ORS 757.268(13)(f)

must be normalized. The adjustments for tax and book depreciation, ICNU/104 at Lines 2 and 3, respectively, include the tax and book depreciation of Pacific Minerals, Inc. Because ICNU did not carefully match the adjustments in ICNU/104, Lines 2 and 3 with the amounts actually reflected in ICNU/104, Line 1, ICNU's alternative calculation is not compliant with the normalization requirements of the IRC.

- The adjustments for tax and book depreciation, ICNU/104, Lines 2 and 3, respectively, are allocated at a different ratio than the amounts included in pre-tax book-income and taxable income. Again, because ICNU did not carefully match the adjustments in ICNU/104, Lines 2 and 3 with the amounts actually reflected in ICNU/104, Line 1, ICNU's alternative calculation is not compliant with the normalization requirements of the IRC. Using ICNU's own amounts, Highly Confidential Joint Testimony Exhibit/202 illustrates that when this error is corrected, ICNU's calculation generates a surcharge, not a refund.
- Ms. Blumenthal erroneously testifies that basis differences are not required to be normalized by the IRC.[6] For example, as clarified in IRS Notice 87-82, the basis difference for Contributions in Aid of Construction (CIAC) is required to be normalized. ICNU's alternative calculation does not normalize the basis difference for CIAC and, therefore, is not compliant with the normalization requirements of the IRC. A copy of IRS Notice 87-82 is provided as Exhibit Joint Testimony/204.

Q. Is the exclusion of deferred income tax expense from ICNU's alternative

[6] ICNU/100, Blumenthal/4, Lines 18-24.

calculation consistent with amounts reflected in taxes authorized to be collected in rates?

A. No. The Commission's historic practice is to establish the level of income taxes in rates on a fully normalized basis. In other words, the Commission has adopted the normalized method of accounting for all of the Company's temporary book-tax differences. Accordingly, taxes authorized to be collected in rates includes all of the current and deferred taxes generated by the regulated operations of the utility. ICNU's alternative calculation attempts to exclude all deferred income taxes not required to be normalized by the IRC, otherwise known as the flow-through method of accounting. In this way, ICNU's alternative calculation of taxes paid contains a significant mismatch when compared against taxes authorized to be collected in rates. It also implies a major change in the Commission's approach to the treatment of deferred taxes in rates by applying flow-through accounting instead of fully normalizing deferred taxes. In response to PacifiCorp Data Request 1.6, Ms. Blumenthal acknowledged that she was unaware of what normalized taxes are included in the taxes collected calculation. See Exhibit Joint Testimony/203.

Q. Was ICNU a party to the stipulations signed in PacifiCorp's most recent rate case, UE 217?

A. Yes. ICNU signed the stipulation resolving issues in PacifiCorp's most recent rate case. In UE 217, the terms of the stipulation included a forecast test year revenue requirement and results of operations. The deferred taxes included in the forecasted test year were calculated using a fully-normalized approach. The

Stipulating Parties, including ICNU, agreed that the stipulation would result in rates that were fair, just and reasonable.

Response to ICNU's Testimony on Part 2 of the Stipulation (Staff and PacifiCorp)

Q. Please summarize your testimony on Part 2 of this Stipulation.

A. Staff's and PacifiCorp's testimony explains that, in addition to being overly generalized, Ms. Blumenthal's testimony on the normalization requirements of the IRC is erroneous and, therefore, her testimony cannot be relied upon for the purposes of evaluating Part 2 of the Joint Stipulation. Because CUB does not believe that the temporary rule revision will result in a normalization violation, CUB respectfully disagrees with the portion of the Staff's and PacifiCorp's testimony which relates to the need to file a PLR. CUB's testimony on this matter is already set forth in Joint Testimony/100, Feighner/10-11, and is not repeated here.

Q. Do Staff and PacifiCorp agree with Ms. Blumenthal's testimony on IRC normalization?

A. No. Ms. Blumenthal's testimony on income tax normalization is overly generalized and erroneous. While Ms. Blumenthal characterizes normalization requirements of the IRC as "clear and straightforward,"[7] as discussed above, her own calculation in ICNU/104 fails to comply with these requirements in at least three ways as discussed on page 6. Furthermore, Ms. Blumenthal minimizes the importance of compliance with IRC normalization requirements and the

[7] ICNU/100, Blumenthal/10, Lines 11-12.

consequences of non-compliance.[8] This is contrary to a significant policy of SB 408, which is to "ensure compliance with the normalization requirements of federal tax law." ORS 757.268 (8)(b).

Q. Please comment on Ms. Blumenthal's position that the Company should not file a PLR request with the IRS to address the revisions to OAR 860-022-0041(4)(d) addressed in the Commission's temporary rulemaking.

A. Given the normalization violations embedded in ICNU/104 and Ms. Blumenthal's testimony downplaying the importance of compliance with IRC normalization requirements, the Commission should decline to rely on her testimony dismissing the need for a PLR.

Q. If the Commission revises OAR 860-022-0041(4)(d) as proposed in the AR 547 temporary rulemaking, do Staff and the Company recommend filing a PLR request with the IRS reflecting the rule change?

A. Yes. OAR 860-022-0041(4)(d) is a key provision that was adopted to ensure the rules' compliance with the IRC and should be revisited with the IRS in the form of a PLR request if it is revised by the Commission. The normalization requirements of the IRC are highly technical and complex, and in Mr. Fuller's capacity as a manager of the Company's obligation to maintain compliance with the normalization requirements of the IRC, he recommends that a PLR request be filed with the IRS to ensure that SB 408's novel approach to establishing the level of income taxes included in rates in Oregon continues to be compliant. Staff concurs. This same prudent step was taken in December 2006 upon the adoption of the

[8] ICNU/100, Blumenthal/10, Lines 17-25.

permanent rules in accordance with OAR 860-022-041(8)(g). And, until the Company and the Commission receive confirmation the rules as revised continue to be compliant, the difference between the Company's surcharge under the currently enacted rules and the amount agreed to in Part 1 of the Stipulation should be deferred.

Q. Do the Stipulation provisions include customer protection regarding the above referenced deferral?

A. Yes. Part V of the Stipulation includes specific provisions for the protection of customers that includes the length of time the deferral may accrue interest and that it may only accrue interest at the modified blended treasury rate rather than at PacifiCorp's cost of capital. In addition, the Stipulation provides for an expiration date for interest to accrue should a PLR take longer than a specified period of time. Each of these agreements provides additional protections for customers.

Q. Does this conclude your testimony?

A. Yes.

WITNESS QUALIFICATION STATEMENT

NAME: Bob Jenks

EMPLOYER: Citizens' Utility Board of Oregon

TITLE: Executive Director

ADDRESS: 610 SW Broadway, Suite 400
Portland, OR 97205

EDUCATION: Bachelor of Science, Economics
Willamette University, Salem, OR

EXPERIENCE: Provided testimony or comments in a variety of OPUC dockets, including UE 88, UE 92, UM 903, UM 918, UE 102, UP 168, UT 125, UT 141, UE 115, UE 116, UE 137, UE 139, UE 161, UE 165, UE 167, UE 170, UE 172, UE 173, UG 152, UM 995, UM 1050, UM 1071, UM 1147, UM 1121, UM 1206, UM 1209, UE 178, UE 179, UE 180, UE 189, UE 196, UE 204, UE 207, UE 208, UE 210, UE 215, UE 217, UE 219, UG 153, UG 163, UG 170, UG 181, UM 1234, UM 1264, UM 1283, UM 1286, UM 1354, UM 1416, UM 1431. Participated in the development of a variety of Least Cost Plans including providing analysis of the costs of carbon regulation, analysis of new coal plants, and analysis of the closure of the Boardman coal plant. Participated in proceedings analyzing and establishing conditions on electric, natural gas, and telecommunication mergers. Provided analysis related to expanding energy efficiency programs and renewable energy in Oregon. Provided testimony to Oregon Legislative Committees on consumer issues relating to energy and telecommunications, including issues related to energy efficiency standards, electric deregulation, renewable portfolio standards, and utility taxes. Lobbied the Oregon Congressional delegation on behalf of CUB.

Between 1982 and 1991, worked for the Oregon State Public Interest Research Group, the Massachusetts Public Interest Research Group, and the Fund for Public Interest Research on a variety of public policy issues.

MEMBERSHIP: Oregon Energy Planning Council
Oregon Department of Energy Advisory Committee
Oregon Department of Environmental Quality Fiscal Advisory Committee for BART rulemaking

National Association of State Utility Consumer Advocates
Board of Directors, Environment Oregon Research and Policy Center

Item		Workpaper Reference	ICNU/104 Reference	A Total Company	B Oregon Allocation	C Oregon Allocated	D ICNU/104 - Edited	E Difference
1.	Pre-Tax Book Income	TP4	**	[redacted]	26.7944%	[redacted]		0
2.	Book Depreciation on Public Utility Property	F1	**	[redacted]	26.7944%	[redacted]		0
3.	Tax Depreciation on Public Utility Property	F1	**	[redacted]	26.7944%	[redacted]		0
4.	Other Book-Tax Differences	Line 5 - Line 4	**	[redacted]	26.7944%	[redacted]		0
5.	**Taxable Income / (Loss)**	TP4	**Line 1**	[redacted]		[redacted]		**0**
6.	Addback: Tax Depreciation on Public Utility Property	F1	Line 2	[redacted]		[redacted]		[redacted]
7.	Deduct: Book Depreciation on Public Utility Property	F1	Line 3	[redacted]		[redacted]		[redacted]
8.	**Taxable Income Adjusted for Depreciation on Public Utility Property**		**Line 4**	[redacted]		[redacted]		[redacted]
9.	Federal Statutory Tax Rate		Line 5	[redacted]		[redacted]		[redacted]
10.	**Federal Tax on Taxable Income Adjusted for Depreciation on Public Utility Property**		**Line 6**	[redacted]		[redacted]		[redacted]
11.	"Non-Depreciation" Deferreds	TP10-4	Line 9	[redacted]		[redacted]		[redacted]
12.	**Normalized Tax Liability**		**Line 6 + 9**	[redacted]		[redacted]		[redacted]
13.	Taxes Collected in Rates		Line 7	[redacted]		[redacted]		[redacted]
14.	**Difference**		**Line 10**	[redacted]		[redacted]		[redacted]

		Oregon	Total	Oregon Allocation
15.	Operating Revenue for Return	[redacted]		

** In this exhibit, the Parties have modified ICNU/104 by adding lines 1 through 4 for the purposes of illustrating the inconsistency between the amount of book and tax depreciation actually reflected in arriving at taxable income on Line 1 of ICNU/104 and the adjustments for tax and book depreciation on Line 2 and Line 3 of ICNU/104. In doing so, ICNU's alternative calculation is not compliant with the normalization requirements of the Internal Revenue Code. In Column D of this exhibit, the Parties have edited the adjustments for tax and book depreciation to match the amounts actually reflected in Line 1 of ICNU/104, the result of which is a surcharge, not a refund.

Note This exhibit was prepared as an illustration of one error within ICNU's calculation and does not serve as a substitute or alternative calculation to the standalone taxes paid result in the stipulation.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UE 177(4)

ICNU'S RESPONSE TO PACIFICORP'S DATA REQUEST NO. 1.1

FEBRUARY 17, 2011

Data Request No. 1.1:

See ICNU/100, Blumenthal/2, lines 17-19. Please confirm that PacifiCorp's stand-alone taxes paid amount reflected in the Stipulation is calculated as required by OAR 860-022-0041. If not, please cite any provision of OAR 860-022-0041 which ICNU believes is violated by the calculation of the stand-alone taxes paid amount reflected in the Stipulation.

Response to Data Request No. 1.1:

Please see page 3, lines 6-8 of Ms. Blumenthal's testimony.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UE 177(4)

ICNU'S RESPONSE TO PACIFICORP'S DATA REQUEST NO. 1.2

FEBRUARY 17, 2011

Data Request No. 1.2:

Please reconcile the refund proposed at ICNU/100, Blumenthal/3, line 4 with the refund proposed at ICNU/100, Blumenthal/11, line 17.

Response to Data Request No. 1.2:

The amount at ICNU/100, Blumenthal/3, line 4 is in error. The amount at ICNU/100, Blumenthal/11, line 17 is correct and Ms. Blumenthal agrees to the amount on ICNU/104 at line 8.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UE 177(4)

ICNU'S RESPONSE TO PACIFICORP'S DATA REQUEST NO. 1.3

FEBRUARY 17, 2011

Data Request No. 1.3:

See ICNU/100, Blumenthal/3, line 9-12. Please confirm that Ms. Blumenthal's calculation of taxes collected in rates includes state taxes, but her calculation of taxes paid excludes state taxes.

Response to Data Request No. 1.3:

See ICNU/104 for the calculation of taxes paid. The state and local taxes included in rates were determined in the Company's last general rate case. Ms. Blumenthal does not know what amount, if any, was included.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UE 177(4)

ICNU'S RESPONSE TO PACIFICORP'S DATA REQUEST NO. 1.4

FEBRUARY 17, 2011

Data Request No. 1.4:

See ICNU/100, Blumenthal/11, lines 1-17. Please confirm that the methodology used for calculating income tax expense in ICNU/104 employs the flow-through method of accounting for temporary book-tax differences not required to be normalized by the Internal Revenue Code.

Response to Data Request No. 1.4:

ICNU/104 shows the impact of recognizing non-depreciation related normalized taxes as well as the taxes paid including only the depreciation related normalization required by the Internal Revenue Code.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UE 177(4)

ICNU'S RESPONSE TO PACIFICORP'S DATA REQUEST NO. 1.5

FEBRUARY 17, 2011

Data Request No. 1.5:

See ICNU/100, Blumenthal/11, lines 1-17. Is ICNU's position that SB 408 mandates flow-through accounting for all book-tax differences where normalization is not required by the Internal Revenue Code? If yes, please provide all evidence that supports this position. If no, please explain ICNU's justification for using flow-through accounting in this context, given the Oregon Commission's historic practice of accounting for income taxes on a fully normalized basis.

Response to Data Request No. 1.5:

No. The reason for showing the taxes paid without normalizing non-depreciation differences is provided beginning at line 21 of ICNU/100, Blumenthal/11.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UE 177(4)

ICNU'S RESPONSE TO PACIFICORP'S DATA REQUEST NO. 1.6

FEBRUARY 17, 2011

Data Request No. 1.6:

See ICNU/100, Blumenthal/11, lines 1-17. Does Ms. Blumenthal acknowledge that PacifiCorp's taxes collected in rates reflect income taxes on a fully normalized basis? If yes, please explain why it is appropriate for Ms. Blumenthal's calculation to use fully normalized accounting for taxes collected in rates and flow-through accounting for taxes paid. If no, please provide all evidence in support of Ms. Blumenthal's position that PacifiCorp's taxes collected in rates reflect flow-through accounting.

Response to Data Request No. 1.6:

Ms. Blumenthal does not know what normalized taxes are included in rates in the Company's general rate cases.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UE 177(4)

ICNU'S RESPONSE TO PACIFICORP'S DATA REQUEST NO. 1.7

FEBRUARY 17, 2011

Data Request No. 1.7:

See ICNU/100, Blumenthal/11, lines 16-17. Please confirm that Ms. Blumenthal's calculation of a tax refund does not include an adjustment for the iterative tax effect as provided in OAR 860-022-0041.

Response to Data Request No. 1.7:

Ms. Blumenthal's calculation is provided in ICNU/104.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UE 177(4)

ICNU'S RESPONSE TO PACIFICORP'S DATA REQUEST NO. 1.8

FEBRUARY 17, 2011

Data Request No. 1.8:

See ICNU/100, Blumenthal/11, Line 21-22. Please explain the basis for the statement in that "Deferred taxes, both the current provision and accumulated deferred taxes, are not reviewed and analyzed in general rate cases in Oregon."

Response to Data Request No. 1.8:

This statement is based on conversations with Staff and review of the information provided in general rate cases.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UE 177(4)

ICNU'S RESPONSE TO PACIFICORP'S DATA REQUEST NO. 1.9

FEBRUARY 17, 2011

Data Request No. 1.9:

See ICNU/104, line 1. Please confirm that the allocation methodology used to allocate Total PacifiCorp taxable income (loss) per Form 1120 to Oregon is not based on PacifiCorp's Revised Protocol allocation methodology.

Response to Data Request No. 1.9:

Due to the limitations imposed by the safe room requirements in effect in this case, Ms. Blumenthal does not have the ability to review the Company's workpapers to confirm or deny this statement.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UE 177(4)

ICNU'S RESPONSE TO PACIFICORP'S DATA REQUEST NO. 1.10

FEBRUARY 17, 2011

Data Request No. 1.10:

See ICNU/104, line 1. Please confirm that the Total PacifiCorp taxable income (loss) per Form 1120 does not include the taxable income (loss) of Pacific Minerals, Inc.

Response to Data Request No. 1.10:

Due to the limitations imposed by the safe room requirements in effect in this case, Ms. Blumenthal does not have the ability to review the Company's workpapers to confirm or deny this statement.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UE 177(4)

ICNU'S RESPONSE TO PACIFICORP'S DATA REQUEST NO. 1.11

FEBRUARY 17, 2011

Data Request No. 1.11:

See ICNU/104, line 1. Please confirm that the Total PacifiCorp taxable income (loss) per Form 1120 contains non-utility costs, including charitable contributions.

Response to Data Request No. 1.11:

Due to the limitations imposed by the safe room requirements in effect in this case, Ms. Blumenthal does not have the ability to review the Company's workpapers to confirm or deny this statement.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

DOCKET NO. UE 177(4)

ICNU'S RESPONSE TO PACIFICORP'S DATA REQUEST NO. 1.12

FEBRUARY 17, 2011

Data Request No. 1.12:

See ICNU/104, line 1. Please confirm that the interest expense included in the Total PacifiCorp taxable income (loss) per Form 1120 is not based on the interest synchronization methodology.

Response to Data Request No. 1.12:

Due to the limitations imposed by the safe room requirements in effect in this case, Ms. Blumenthal does not have the ability to review the Company's workpapers to confirm or deny this statement.

Checkpoint Contents
Federal Library
Federal Source Materials
IRS Rulings & Releases
Revenue Rulings & Procedures, Notices, Announcements, Executive & Delegation Orders, News Releases & Other IRS Documents
Notices (1980 to Present)
1987
Notice 87-82, 1987-2 CB 389 -- IRC Sec(s). 118

Notices

Notice 87-82, 1987-2 CB 389, IRC Sec(s). 118

Headnote:

Notice 87-82, 1987-2 CB 389

Reference(s): Code Sec. 118;

Full Text:

Regulated Public Utilities--Contributions in Aid of Construction After Tax Reform

This notice provides guidance with respect to the treatment of contributions in aid of construction after enactment of section 824 of the Tax Reform Act of 1986 (the "Act"), Pub.L. No. 99-514 [1986-3 (Vol. 1) 291].

I. Background

Section 118(b) of the Internal Revenue Code of 1954 (the "1954 Code") provided a special rule for contributions in aid of construction received by regulated public utilities ("utilities") providing certain services. Under this rule, contributions in aid of construction were treated as contributions to capital and were therefore excluded from gross income under section 118(a). Section 824 of the Act changed the treatment of amounts received as contributions in aid of construction after December 31, 1986, in taxable years ending after such date. New section 118(b) of the Internal Revenue Code of 1986 (the "1986 Code") expressly provides that contributions in aid of construction and other contributions made by a customer or potential customer (collectively, "CIACs") are not contributions to capital and thus are not excluded from gross income under section 118. Accordingly, such amounts are required to be included in gross income under section 61.

II. Relocation of Utility Facilities

The Internal Revenue Service has received numerous inquiries regarding the Federal income tax treatment under the 1986 Code of fees and other amounts received by utilities for relocating utility facilities ("relocation fees"). Frequently, utilities are required to relocate utility facilities in order to accommodate a public right-of-way. For example, a utility line may have to be relocated in order to allow for the construction or improvement of a public highway. Similarly, overhead utility lines may be placed underground under a governmental program undertaken for reasons of community esthetics and public safety. In such cases, the utility typically receives, directly or indirectly, a relocation fee in reimbursement for the costs of relocating the utility facilities.

The legislative history to section 824 of the Act indicates that Congress viewed the receipt by utilities of CIACs as a prepayment for future services that the utilities would provide to their customers. H.R. Rep. No. 99-426, 99th Cong., 1st Sess. 643-45 (1985) ("House Report"). Congress viewed the exclusion of these amounts from income as inappropriate and accordingly, required that a utility

report as an item of gross income the value of any property, including money, that it receives to provide, or encourage...the provision of, services to or for the benefit of the person transferring the property. A utility is considered as having received property to encourage the provision of services if the receipt of the property is a prerequisite to the provision of services, if the receipt of the property results in the provision of services earlier than would be the case had the property not been received, or if the receipt of the property otherwise causes the transferor to be favored in any way.

House Report at 644.

The legislative history to the Act also indicates that a

person transferring the property will be considered as having been benefitted [from such transfer] if he is the person who will receive the [utility] services, an owner of the property that will receive the services, a former owner of the property that will receive the services, or if he derives any benefit from the property that will receive the services. Thus, a builder who transfers property to a utility in order to obtain services for a house that he was paid to build will be considered as having benefitted from the provision of the services...despite the fact that the builder may never have had an ownership interest in the property and may make the transfer to the utility after the house has been completed and accepted.

House Report at 644-45.

In contrast, the legislative history to the Act provides that the repeal of section 118(b) of the 1954 Code does not affect transfers of property which are not made in connection with the provision of services, including situations where "it is clearly shown that the benefit of the public as a whole was the primary motivating factor in the transfers." *Id.*

Based on the foregoing, the Federal income tax treatment of many types of relocation fees has not be affected by section 824 of the Act. If, for example, it can be shown that a particular payment received by a utility does not reasonably relate to the provision of services by such utility to or for the benefit of the person making the payment but rather relates to the benefit of the public at large, then the payment is **<Page 390>** not treated as a CIAC under section 118(b) of the 1986 Code. For example, relocation payments received by a utility under a government program for placing utility lines

underground shall not be treated as CIACs where such relocation is undertaken for purposes of community esthetics and public safety and not for the direct benefit of particular customers of the utility in their capacity as customers. *See Brown Shoe Co. v. Commissioner,* 339 U.S. 583 (1950) (payments made by certain community groups as an inducement to location or expansion of taxpayer's factory were held to be contributions to taxpayer's capital because the payments were made to benefit the community at large, and not for services). Similar principles apply where the utility is being reimbursed for the costs of relocating utility lines to accommodate the construction or expansion of a highway and not for the provision of utility services.

Moreover, taxpayers failing to meet the criteria for exclusion of relocation fees under section 118(a) may treat such fees under the provisions of section 1031 or 1033 if the conditions of the respective section are otherwise met.

In other cases, however, relocation fees are treated as CIACs and included in gross income because they relate to the provision of services by the utility to or for the benefit of the person making the payment. Assume, for example, that a customer of a utility moves its business office to another location and is required to pay the utility a fee to relocate the utility facilities to the new office site. The utility has received the fee as a prerequisite to the provision of services to the new location, and thus the fee is a CIAC under section 118(b) and is included currently in the utility's income. In addition, assume a real estate developer pays a fee to a utility in return for the utility extending new underground services to a particular tract being developed. Since the payment is being made to or for the benefit of the developer and since the fee is a prerequisite to the provision of underground services to the tract, the fee is a CIAC and currently included in the utility's gross income.

Similarly, assume that a potential customer of a utility is required (either by the utility or by a governmental entity) to pay the utility for the costs of relocating utility facilities in order to obtain access to utility services for a site the customer is developing. Since the payment of the relocation fees is a prerequisite to obtaining utility services, the payment is a CIAC and is included in the utility's income, regardless of whether the particular utility facilities being relocated are related to the site the customer is developing.

Relocation fees are treated as CIACs and included in gross income if such payments relate to the provision of services by the utility, regardless of the status or identity of the customer from whom the fees are received. For example, assume a utility receives a payment relating to the relocation or extension of utility facilities to a newly constructed municipal building (*e.g.,* a public hospital, civic center, or museum) whose operations are conducted for the benefit of the community at large. Assume also that payment of the relocation fee was required in order to obtain utility services for the new building. Since the relocation fee is a prerequisite to the provision of services to the customer, the fee is a CIAC and included in gross income even though the customer is exclusively engaging in activities for the public benefit. Similarly, payments that are made to a utility as a prerequisite to the utility providing new or additional services to particular customers are treated as CIACs and included in gross income because such payments are a prerequisite to the provision of services by the utility, although a governmental entity may be making the payments in question.

III. Fair Market Value of CIACs

A utility shall include in income the amount of any cash received as a CIAC and the fair market value of all property received as a CIAC. If the property received by the utility will be used in the provision of utility services, all of the relevant facts and circumstances are taken into account in determining the fair market value of the property. Absent unusual circumstances, normally the value of such property provided to a utility is the "replacement cost" of the property, *i.e.,* the cost that another party would incur to construct property that is functionally similar to the subject property and thus could replace such subject property in the performance of the property's intended function. The fact that property received as a CIAC is not included in the utility's rate base or cost of service for regulatory accounting purposes shall not, in any manner, affect the determination of the fair market value of the property for this purpose. *See* Rev. Rul. 87-117, page 61, this Bulletin.

IV. Other Transactions Qualifying as CIACs

A transaction will be treated as a CIAC if such treatment is in accordance with the substance of the transaction, regardless of the form in which such transaction is conducted. For example, a sale of property to a utility at less than its fair market value (with fair market value being determined as described in the provisions of section III of this notice) will be treated as CIAC that is taxable to the utility to the extent of the bargain element in the sale. A lease of property to a utilty at less than its fair market rental value will be treated in a similar manner, with the bargain element inherent in each periodic rent payment taxed to the utility at the time such payment is made.

In addition, a transaction will be treated as a CIAC if the utility effectively obtains the burdens and benefits of ownership with respect to property, although legal title to such property is held by the customer, a governmental entity, or another person. Transactions which purportedly avoid CIAC characterization through the retention of legal title to property by a person other than a utility will be scrutinized carefully and will be treated as taxable CIACs to the utility if, in fact, the utility is, for Federal income tax purposes, the owner of the property. Factors which suggest ownership of the property by the utility include, but are not limited to, (i) whether the utility is responsible for maintaining the property; (ii) whether the utility effectively has unrestricted access to and control of the property; and (iii) whether the utility would bear legal liabiilty with respect to a malfunction of or accident involving the property.**<Page 391>**

Similarly, any payment to a utility (whether such payment is direct or indirect) will be treated as a CIAC if such payment is made to obtain the provision of services from the utility and otherwise meets the requirements of this notice. Thus, for example, a utility will be taxed on a CIAC regardless of whether the customer engages the services of an unrelated contractor to construct the property to which the CIAC relates or whether the customer instead directly pays the CIAC to the utility with the utility itself assuming responsibility to construct the related property.

Moreover, a purported loan to a utility from a person benefitting from utility services relating to the loan (*e.g.,* a real estate developer, customer, or potential customer) will be treated as a CIAC and included in the utility's gross income if the transaction lacks the economic characteristics of a genuine loan for Federal income tax purposes. As an example, where repayment of a "loan" by a utility to the lender is contingent and the contingent loan is made to allow or to encourage the utility to provide services for the benefit of the person making the loan, the amount received by the utility will be treated as a taxable CIAC. Where a utility included the entire amount of such a "loan" in taxable

income as a CIAC, repayments of such loan by the utility to the lender would normally be deductible by the utility when made.

Finally, where a genuine loan with a "below-market" interest rate is made from persons benefitting from utility services to the utility, the utility shall currently include in income as a CIAC the benefit that the utility receives from the below-market interest rate. *See* section 7872.

V. Normalization of CIACs

Section 168(f)(2) of the 1986 Code effectively provides that a utility is required to use a normalization method of accounting with respect to public utility property in order to use the accelerated methods of depreciation under section 168 with respect to that property. Under section 168(i)(9)(C), a utility not using a normalization method of accounting with respect to public utility property is required to use a method of depreciation and a depreciation period for such property that is the same as the method and period used by the taxpayer in computing its depreciation expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account. Public utility property is defined in section 167(1)(3)(A) as property used predominantly in the trade or business of furnishing or selling various enumerated utility services at rates established or approved by certain governmental entities, public utility commissions, and other similar bodies. Public utility property includes property that is received as a CIAC or that is financed or acquired with the proceeds of CIACs. In any such case, the CIAC property is subject to the normalization rules of sections 167 and 168.

For regulatory accounting purposes, utilities typically disregard the receipt of CIACs on their regulated books of account and do not include CIACs or CIAC property in income, cost of service, or rate base. This method of accounting (the "noninclusion method") is equivalent to including a CIAC in income in the year of receipt and depreciating the related CIAC property in its entirety in the same year. Accordingly, a utility using the noninclusion method of accounting for a CIAC will be treated for purposes of the normalization rules as if it computed its regulated tax expense by depreciating the related CIAC property in its entirety in the year in which the CIAC is received. the Internal Revenue Service believes that this treatment is consistent with the noninclusion method of accounting and is necessary in order to carry out the purposes of the normalization rules.

Under the normalization rules, a utility must make adjustments to a reserve to reflect the deferral of taxes resulting from the difference between the amount of depreciation used to determine the utility's Federal income tax liability and the amount of depreciation used to compute regulated tax expense. In the typical case, part of the utility's tax expense is deferred (*i.e.,* taxes are actually paid to the Federal government after they are taken into account under the regulatory accounting method) because property is depreciated more rapidly in determining Federal income tax liability than in computing regulated tax expense. If a utility uses the noninclusion method of accounting for CIACs, however, CIAC property is depreciated less rapidly in determining Federal income tax liability than in computing regulated tax expense, and taxes are paid before they are taken into account under the regulatory accounting method. This prepayment, or negative deferral, of tax is also subject to the normalization rules, and the utility must make adjustments to the reserve for deferred taxes to reflect the prepayment.

Under these adjustments, the amount of deferred taxes on the utility's regulated books of account is offset or decreased by the prepayment of tax resulting from the taxable receipt of the CIAC. Thus, if a taxpayer reduces rate base by the deferred taxes resulting from normalization, any prepayment to tax resulting from the normalization of CIACs will increase the rate base to which the utility's rate of return is applied. Similarly, if a taxpayer treats the deferred taxes resulting from normalization as "zero-cost" or "no-cost" capital for ratemaking purposes, any prepayment of taxes resulting from the normalization of CIACs will decrease the amount of zero-cost capital or no-cost capital for ratemaking purposes.

Further adjustments are made to the reserve for deferred taxes when the timing differences with respect to CIAC property reverse. This occurs as depreciation is taken into account in determining Federal income tax liability over the applicable recovery period prescribed under section 168. As the reversal occurs, previously paid taxes will be taken in account under the regulatory accounting method that will reduce, ultimately to zero, the amount of prepaid tax resulting from the normalization of the CIAC.

If, in its regulatory accounting for CIACs, a utility uses or changes to a method other than the noninclusion method, the normalization rules apply to timing differences determined under the regulatory accounting method used by the utility. For example, if a utility changes to a regulatory accounting method under which CIAC property is depreciated over its useful life, the deferral of tax **<Page 392>** resulting from the normalization of a CIAC taken into account under the new method would depend on the difference between the depreciation taken into account under the new method and the depreciation taken into account in determining Federal income tax liability.

VI. Normalization Rules Not Applicable to Certain CIACs

The normalization rules do not apply to a CIAC (or property related thereto) if the following conditions are satisfied:

(1) The CIAC is included in gross income solely by reason of the amendments to section 118(b) of the Code by section 824 of the Act;

(2) The utility uses the noninclusion method of accounting for the CIAC;

(3) The Federal income tax attributable to the receipt of the CIAC is not taken into account in determining cost of service for any person (other than, perhaps, the person from whom the CIAC is received, *i.e.,* the "contributor"); and

(4) The contributor pays the utility an additional amount that is reasonably intended to indemnify or reimburse the utility for the prepayment of tax resulting from receipt of the CIAC (an "indemnification").

In the case of CIAC that satisfies these conditions (a "grossed-up" CIAC), neither the utility nor its ratepayers (other than the contributor) are affected by the prepayment of taxes that results from receipt of the CIAC. Thus, it is not necessary to normalize a grossed-up CIAC in order to carry out the purposes of the normalization rules. *See* section 167(1)(5). Alternatively, grossed-up CIACs may be normalized in the same manner as other CIACs. Thus, a utility may use an accelerated method of depreciation under section 168 with respect to its public utility property whether or not grossed-up CIACs are normalized by the utility. The utility's depreciable basis in the CIAC property is

determined under other provisions of the Code and is independent of the existence of an indemnification. If, for example, a utility receives a total payment from a contributor of $160 and expends $100 in constructing the CIAC property, the utility's depreciable basis in the property is $100. Similarly, if a utility receives a total payment from a contributor of $100 and expends $100 in constructing the CIAC property (with the income tax payments pertaining to the CIAC being obtained from other sources), the utility's depreciable basis in the property is also $100.

The condition of indemnification, necessary in order for a payment to qualify as a grossed-up CIAC, is required only for the prepayment of tax that results from receipt of the CIAC. Thus, the amount of the indemnification may be determined by reducing the amount of tax attributable to the receipt of the CIAC by the present value of the tax benefits to be obtained by depreciating the CIAC property in determining the utility's Federal income tax liability. A reduction attributable to such tax benefits is not required, however, because the identity of the ultimate recipient of those benefits pertaining to the grossed-up CIAC (*i.e.,* the contributor, the utility, or the utility's ratepayers) is a matter outside the scope of the normalization rules and Federal income tax laws.

A utility may establish that an indemnification has occurred (i) by reference to a contract or agreement in which the contributor and the utility provide for such indemnification, (ii) by reference to an indemnification requirement contained in a rate order issued by a regulatory commission or in the record of a hearing or similar proceeding conducted by such a commission, or (iii) by any other reasonable method or procedure. Moreover, the Internal Revenue Service will not scrutinize the adequancy of an indemnification in any case in which the parties have attempted in good faith to indemnify or reimburse the utility for the prepayment of tax that results from receipt of the CIAC.

VII. Accounting Treatment of CIACs By Customers

Sections 1.461-1(a)(1) and (2) of the Income Tax Regulations provide that taxpayers using the cash and accrual methods of accounting, respectively, may not currently deduct the total amount of an expenditure which results in the creation of an asset having a useful life which extends substantially beyond the close of the taxable year. Instead, such taxpayers are required to capitalize such expenditures as assets and deduct the costs of the expenditures over the useful life of the asset in question. *See, e.g.,* Rev. Rul. 70-413, 1970-2 C.B. 103.

Any taxpayer paying a CIAC to a utility is incurring an expenditure which results in the creation of an intangible asset having a useful life extending substantially beyond the close of the taxpayer's taxable year. If a taxpayer incurs a CIAC with respect to property used in a trade or business and is required to replace the CIAC property upon its obsolescence or deterioration, the amount of such payment is capitalized and deducted on a pro rata basis over the useful life of the asset. In such a situation, the useful life of the intangible asset would correspond to the economic life (in contrast to the tax life or recovery period) of the public utility property to which the CIAC relates. *See, e.g.,* Rev. Rul. 69-229, 1969- 1 C.B. 86. In contast, if the taxpayer incurs a CIAC with respect to property used in a trade or business and is not required to replace the CIAC property upon its obsolescence or deterioration, the intangible asset has an indeterminate economic life. In such a case, the taxpayer must capitalize the payment and is not permitted to amortize the amount of the prepaid asset. *See, e.g.,* Rev. Rul. 68-607, 1968-2 C.B. 115.

In the case of a taxpayer (*e.g.,* a real estate developer or home builder) who incurs CIACs with respect to property primarily held for sale to customers in the ordinary course of the taxpayer's business, the cost of the CIAC should be capitalized. The intangible asset should be allocated to the property held for sale to customers and deducted when such property and the related intangible asset are sold.

VIII. Transactions not Affected by this Notice

This notice does not apply to transactions which do not involve CIACs as described under section 118(b) and this notice. Thus, for example, this notice does not apply to "customer connection fees" as defined in section 118(b)(3)(A) of the 1954 Code (Such connection fees are currently included in gross income by utilities under both the 1986 and **<Page 393>** 1954 Codes). Similarly, this notice does not apply to payments made from utilities to their customers. Thus, for example, this notice does not apply to payments made to a public utility in connection with the supply of electricity to such utility by a cogenerating facility under the Public Utilities Regulatory Policy Act of 1978 ("PURPA"), Pub. L. No. 95-617. No inference is intended herein as to the treatment of such transactions.

CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing document in Docket UE 177 on the following named person(s) on the date indicated below by email and first-class mail addressed to said person(s) at his or her last-known address(es) indicated below.

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