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

TO: ALL PARTIES

DOCKET NO. AR 499

AVISTA CORPORATION

SB 408 TAX FILINGS – UG 171

2003, 2004 AND 2005

FROM: CARLA OWINGS, UTILITY ANALYST,
PUBLIC UTILITY COMMISSION

DATE: DECEMBER 15, 2006

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

On October 13, 2006, Avista Corporation (Avista) filed UG 171, its tax report covering the calendar years 2003, 2004 and 2005 pursuant to Senate Bill 408 (SB 408) (codified at ORS 757.267, 757.268 and OAR 860-022-0041).

The information contained in these tax reports represents highly confidential and sensitive information. Staff has adhered to the handling of the confidential information in these filings consistent with Commission Order No. 06-033. In addition, 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 finds that Avista's original filing was very detailed and adequately documented its procedures and methodologies compliant with the current AR 499 rules. Staff acknowledges Avista for its efforts to provide a structure and presentation that facilitated Staff's review.

Staff reviewed in great specificity one particular tax year, each calculation and all documentation provided by the Company in support of each calculation. For Avista this tax year was 2005. Staff conducted interviews with the Company by phone, and sent questions to Avista on December 6, 2006 for further clarification. On December 14, 2006, Avista provided narrative responses to Staff's inquiries. For Avista's 2003 and 2004 filings, Staff

reviewed the methodology, consistency with the 2005 filing, documentation and accuracy of mathematical calculations.

In the process of these reviews, Staff has discovered a few inaccuracies specific to Avista's filing, as well as inconsistencies that appear to relate more globally to AR 499 rules as they currently exist and/or to the interpretation of AR 499 by the utility companies versus Staff's understanding of the current rules.

Following is a description of the inconsistencies Staff found for Avista, followed by the more generic issues Staff raises regarding the rules in general.

Issue 1) Calculation of Tax Benefit for depreciation.

Staff Comment:

The relevant Consolidated Filer for Avista Corporation includes several regulated entities for both gas and electric operations as well as non-regulated entities.

On page 2 of 7, Line 12, calculation of tax benefit for depreciation, Avista may be including the tax benefit of all Public Utility Property (PUP) rather than just the tax benefit of depreciation for those entities that experienced a tax loss in the current tax period.

Additionally, in this calculation, Avista uses the tax benefit of ALL depreciation which appears to include depreciation of a non-regulated entity. On page 14 of 35 of Avista's workpapers, Avista includes a break-down of depreciation for each entity. However, Avista fails to indicate in its worksheet which entities are regulated and which are not. Including the tax benefit for a non-regulated entity should not pose a potential normalization violation and should not be included in this calculation. In this circumstance, this non-regulated entity did not experience a tax loss in this tax period and would not be included for that reason as well.

Staff recommendation:

This issue is addressed as generic issue 1) below. It is Staff intention to raise this issue in up-coming workshops. Staff's current recommendation is that Avista should calculate this adjustment using the tax benefit for depreciation of only regulated entities that experience a tax loss in the current tax period. Staff recommends that Avista modify its workpaper 14 of 35 to include a denotation for regulated entities.

Issue 2) Origin of numbers used to represent ratio calculations.

Staff Comment:

Avista relied upon a current run Oregon Regulated Operations total Gross plant, total wages that represent end-of-period totals. However, Avista uses the Results of Operations report for the gross revenue portion of this ratio calculation which represents a "monthly average" amount. The variation between these totals and the totals for the same categories in the Results of Operations report results in a lower apportionment factor and creates

inconsistencies between the revenue amount and the amounts used for Gross Plant and Wages and Salaries.

Staff recommendation:

Staff recommends that Avista use the Results of Operations report for the Gross Plant amount as well as the Gross Revenues. For the Wages and Salaries total, Staff recommends that Avista run a similar report to generate total Wages and Salaries for the same period based on a monthly average balance, consistent with the other numbers used to calculate this ratio.

Issue 3) Calculation of interest expense for a stand-alone Utility.

Staff Comment:

In its calculation of interest expense, Avista used the Commission Ordered weighted cost of debt from its last rate case. Avista interprets the last statement in ORS 860-022-0041(2)(n)..."in a manner used by the Commission in establishing rates" to indicate that Avista should use the weighted cost of debt ordered in its last rate case as the proper cost of debt to calculate interest.

Staff interprets this rule to mean "in a manner 'consistent' with the Commission methodology to establish rates." Staff believes that the interest portion of the stand-alone calculation should use the Utility's actual results of operations, including the current weighted cost of debt to establish the proper interest calculation.

Staff's reference to the Commission practices in ORS 860-022-0041(2)(n) indicates that the entire ratebase amount needs to be trued-up to the proper interest calculation by taking the current ratebase in that period multiplied by the current weighted cost of debt (adjusted if needed to reflect discrete modifications made in the utility's general rate proceeding).

Staff recommendation:

Staff recommends that Avista use current cost of debt from actual results of operations to perform the interest true-up to the current ratebase for future filings.

If Staff were to request that Avista modify its tax filings for 2003, 2004 and 2005, Staff believes there may be minor impacts to the outcome of Avista's filing. However, Staff believes that if Avista were to implement Staff's recommended methodologies from this first review, the Company's future filings will accurately represent the differences between taxes paid and taxes collected in rates

Current outcome of Avista's filings:

	Difference between "taxes paid" and rate case estimates of "taxes authorized to be collected"
2003	(\$1,403,000)
2004	(\$1,013,000)
2005	(\$1,557,000)

Generic issues:

Staff discovered two generic issues that appear to be global misconceptions between Staff, the Utilities and the rules as they currently exist.

Generic Issue 1) Documentation of Tax Liability.

Staff Comments:

Overall Staff found that most of the Companies did not include original copies or proper documentation of the actual tax filings relied upon for the calculation of its tax liability in these filings. Most companies submitted copies of tax schedules that were modified, incomplete, unsigned and not dated.

Even as a subsidiary of a consolidated tax filer, Staff believes that each subsidiary is required by its Corporate Parent to provide closing statements and pro forma tax filings which are relied upon by the consolidated filer. Staff believes it is prudent for the corporate parent to provide copies of tax forms for each entity of the consolidated filing. This will enable Staff and the other parties to verify, for example, the individual tax losses used to calculate "the floor" for the stand-alone determination. Staff recommends that for future filings, each Utility request such copies be provided for purposes of the accuracy of these filings.

Generic Issue 2) Calculation of Stand-alone Utility (the floor).

Staff Comments:

Pursuant to OAR 860-022-0041(3)(b)(B) and (3)(d)(B), the amount of federal income taxes paid that is properly attributed to the regulated operations is not to be less than the Utility's stand-alone calculation reduced by a proportionate share of the tax losses after adjusting for tax effects of Public Utility Property (PUP). It is Staff's opinion that the adjustment for the tax effects of PUP should ONLY include depreciation for those entities that are regulated AND are experiencing a loss in that tax period and not an adjustment for the tax effects of all public utility property. . Staff believes that in order to avoid IRS

normalization violations, there is no need to add back the tax effect of depreciation related to PUP of regulated utilities that do not have losses.

Staff found that the utility companies tended to make this adjustment for deprecation by including all PUP and not just PUP from entities that experienced a loss in that tax year.

Staff recommendation:

Staff suggests a housekeeping change to this section of the rule clarifying that the “floor” calculation should be based either solely on the losses of unregulated entities in the consolidated group (eliminating the need to make any PUP-related add backs), or alternatively, that the add back should be the amount related to those regulated entities with losses. Staff will make a recommendation in the rulemaking expected next spring.

1 **CERTIFICATE OF SERVICE**

2 I certify that on December 15, 2006, I served the foregoing upon the parties in this
3 proceeding hereto by electronic mail and sending a true, exact and full copy by regular mail,
4 postage prepaid or by shuttle mail/hand deliver to the parties accepting paper service.

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