BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **AVISTA CORPORATION d/b/a AVISTA UTILITIES,** **Respondent.**	**DOCKETS UE-170485 and UG-170486 (*Consolidated*)**

COMMISSION STAFF RESPONSE TO AVISTA CORPORATION'S RESPONSE TO BENCH REQUEST NO. 1

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I. INTRODUCTION

On December 22, 2017, President Trump signed H.R.1 – An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018 (The Tax Cuts and Jobs Act, or "TCJA") into law. The TCJA amends the Internal Revenue Code to reduce tax rates and modify policies, credits, and deductions for individuals and businesses. The most notable impact for utilities regulated by the Commission is the reduction of the federal corporate tax rate from 35 percent to 21 percent.

On December 29, 2017, in dockets UE-171221 and UG-171222, Avista Corporation ("Avista" or "Company") filed a Petition for an order authorizing deferral of federal income tax expenses for the effects of the revisions to the federal income tax code upon its cost of service.

On January 2, 2018, the Commission issued a Notice of Bench Request and Notice of Opportunity to Respond ("Notice") in these dockets. The Notice included Bench Request No. 1, which required Avista to provide information related to the TCJA's impacts on the Company's revenue requirement and the Company's proposed ratemaking treatment(s) for those impacts. The Notice also provided parties with an opportunity to file comments related to Avista's response to the Commission's Bench Request.

Commission Staff ("Staff') has reviewed Avista Corporation's ("Avista") response to Bench Request No. 1 and has prepared the this response.

This response will first summarize Avista's response to Bench Request No. 1. Second, this response will address the TCJA impact on rates in this case. It will then address taxes which have already been collected. Finally, it will comment on the TCJA impact on the rate plan Staff recommends in this case. Throughout Staff's response, I will highlight some regulatory principles relevant to the issue at hand.

1 **II. SUMMARY OF AVISTA'S RESPONSE TO BENCH REQUEST NO. 1**

2 Avista did not fully respond to Bench Request No. 1 because it does not yet know the
3 impact of the TCJA. Avista's response explained why determining the effects of the TCJA on its
4 taxes is a complicated and time-consuming task that affects taxes the Company has already
5 collected, taxes that Avista continues to collect under existing rates, and, the collection of taxes
6 going forward as a result of the new revenue requirement that will result from this general rate
7 case.

8 Avista explained that the Idaho Public Utilities Commission has notified Avista that it
9 must produce a report by March 30, 2018, that explains the ramifications of the tax bill on
10 Avista's service in Idaho. Avista proposes to provide a full response to Bench Request No. 1 on
11 this same date.

12 Avista also proposes to file a rebate tariff, at a later date, to return "excess taxes"[1] to
13 customers. This rebate would return funds to customers that are captured in the deferred
14 accounting mechanism requested in the Company's petition in UE-171221 and UG-171222. The
15 rebate tariff would aim to rebate excess taxes to customers that were collected prior to *and* after
16 January 1, 2018. Subsequent updates to the rebate tariff would be made to reflect the impacts of
17 the new tax law on years 2 and 3 of the rate plan, should the Commission choose to adopt a rate
18 plan.

19 Avista also explains that there are some restrictions imposed by the Internal Revenue
20 Service ("IRS") on the pace of the return of some excess taxes, if the Company is to continue to
21 be eligible for accelerated depreciation.

[1] The Company has collected, and continues to collect, more funds from customers than is needed to cover its tax obligations, including its deferred tax obligations. This is what "excess taxes" refers to.

1 **III. HOW SHOULD THE BENEFITS OF THE TAX CUTS AND JOBS ACT (“TCJA”)**
2 **BE APPORTIONED BETWEEN RATEPAYERS AND SHAREHOLDERS?**

3 The tax benefits of the Tax Cuts and Jobs Act should be 100 percent passed on to
4 ratepayers. The Company appears to agree with this position. In Dockets UE-171221 and UG-
5 171222, Avista has sought the ability to defer excess taxes collected from customers, and
6 acknowledges that “all the financial impacts of changes to the federal tax code” should be
7 “properly incorporated in customers’ rates.”[2]

8 Ensuring that customers receive all of the benefits of TCJA is consistent with the
9 Commission’s ratemaking standards. Corporate income taxes are a pass-through cost that
10 companies have no control over. Taxes are not a cost like operations and maintenance costs,
11 where a revenue requirement is established to cover a reasonable level of costs and the company
12 is incentivized to minimize that cost during the rate period, and is rewarded by pocketing the
13 savings. Instead, income taxes are a cost the company is legally obligated to pay, and so the
14 company should only collect that level of revenue from customers sufficient to cover this legal
15 obligation, and no more. Charging customers more than required to cover the company’s legal
16 obligation to pay income taxes is unreasonable, unfair, and unjust.

17 **IV. PROCEDURAL RECOMMENDATIONS**

18 Avista proposes to file a report with the Commission by March 30, 2018, that answers the
19 Bench Request in full. It is clear from Avista’s response to Bench Request No. 1 that the
20 Company feels it is appropriate “for the Commission and interested parties to audit”[3], and
21 provide commentary on the report. However, under the current Procedural Schedule, Staff and
22 other parties – including Commission policy staff – would have a relatively short amount of time

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[3] Bench Request No. 1 pg 4.

1 to review and comment on Avista's report. The current Procedural Schedule has established

2 April 26, 2018 as the Suspension Date, which is less than one month after Avista intends to file

3 its report. As a practical matter, Commission Staff and other parties would have three weeks at

4 best to respond to Avista's report. In comparison, Idaho staff, for whom the March 30 date

5 appears to have been created, will have 60 days to review and comment on Avista's report.[4]

6 *Commission Staff believes that at least four weeks is necessary to review and comment on*

7 *Avista's March 30 report.* This four week review period applies to Staff's review only and would

8 be *in addition to* any time the Commission itself would need to review the intervening Parties'

9 responses to the Company's report. Staff can also respond to Avista's report with a Staff-updated

10 revenue requirement that incorporates the Company's reported information in that same four-

11 week timeframe. The Company's testimony at the recent evidentiary hearing seemed to suggest

12 that Avista may have the required TJCA-related information as early as mid- to late-February. If

13 that is the case, Staff proposes that Avista provide that information as soon as possible to Staff,

14 the Commission, and the intervening parties to allow for at least four full calendar weeks just to

15 review the Company's report. Alternatively, if the Company cannot provide the requisite

16 information until March 30, Staff recommends the Company voluntarily extend the Suspension

17 Date to allow for the Parties to have at least a four week review period.

18 **V. DETERMINING TAX EXPENSE GOING FORWARD**

19 The most significant change brought by the passage of the TCJA is a change in the corporate

20 tax rate from 35 percent to 21 percent. This change requires a re-calculation of the revenue

21 conversion factor[5] used to convert pre-tax revenue requirements to final revenue requirements. It

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[4] https://www.puc.idaho.gov/orders/recent/Notice_of_Investigation_Order_No_33965.pdf

[5] The revenue conversion factor converts a net income deficiency into a gross revenue income deficiency. It recognizes that a utility would need to collect more than one dollar in gross revenue for each dollar of net operating

1 will also require a re-calculation of several adjustments to the test year that are a function of the
2 corporate income tax rate.
3 Incorporating these changes will have a large impact on revenue requirements. In fact, it
4 is possible that in doing so, the Commission would arrive at a revenue requirement reduction for
5 the first year of rates. Such a result should not be a cause for alarm and should not be interpreted
6 as punishment of the Company. A revenue requirement reduction would simply reflect the fact
7 that the Company no longer needs to collect as much revenue from customers to meet its future
8 income tax obligations as it previously did.

9 **A. The Revenue Conversion Factor**

10 Staff's filed revenue requirement models assumed a 35 percent federal income tax rate. As a
11 result, Staff used a conversion factor of 0.619659 for electric service, and 0.619798 for natural
12 gas service, both of which were based on a 35 percent tax rate. Adjusting Staff's conversion
13 factor to reflect the new, lower tax rate of 21 percent results in a conversion factor of 0.753124
14 for electric service and 0.753293 for natural gas service.

15 **B. Adjustments that are a function of the corporate tax rate**

16 Restating and *pro forma* adjustments in the various revenue requirement models submitted by
17 parties to this case have components that are a function of the corporate income tax rate.
18 Adjustment 2.16 in Exhibit JH-3 is one such example, where debt interest is a function of the
19 corporate tax rate. These components all assumed a 35 percent tax rate, but should now be re-
20 calculated using the new, lower tax rate of 21 percent. Even the test year itself will have to be
21 adjusted to account for the new corporate income tax rate.

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income it keeps for itself. Amongst other things, it is a function of several tax rates, one of which is the federal corporate income tax rate.

1 **C. Expenses no longer deductible**

2 Prior to the passage of the TCJA, public utilities could deduct some expenses from their 3 taxable income. The TCJA has eliminated this provision in some circumstances. For example, 4 utilities lose the benefit of bonus depreciation going forward. Avista's proposed March 30 report 5 promises to shed light on the ramifications of these changes.

6 In the short-term, utilities will likely still have no federal income taxes due, because of 7 net-operating losses ("NOL") from previous years that are carried forward. Once those NOLs are 8 exhausted, utilities are likely to incur income tax obligations. If the loss of bonus depreciation 9 results in taxable income, the utility may use accumulated Production Tax Credits to mitigate the 10 payment of taxes in the current year.

11 **VI. TAXES ALREADY COLLECTED**

12 The Company filed deferred accounting petitions on December 29, 2017, in dockets UE- 13 171221 and UG-171222. The petition seeks "an order authorizing [Avista] to utilize deferred 14 accounting for the impact to its federal income tax (FIT) expenses due to the revisions of the 15 federal income tax code caused by" the TJCA. Avista explains that it "would defer the impact of 16 the changes to federal income tax expenses"[6], and that at a later unspecified date, "the Company 17 will supplement this filing with the expected impact of the changes and with detail of the 18 amounts that have been deferred."[7] The deferred amount will accrue interest at the FERC rate, 19 which is currently 4.25 percent.

20 Staff supports this proposal. Deferred accounting will be necessary in order to facilitate 21 the return of excess taxes to ratepayers.

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[6] Petition page 3.
[7] Petition page 3.

1 **A. Explanation of DFIT**

2 Deferred taxes arise due to differences in how the Company's capital assets are
3 depreciated for utility ratemaking purposes ("straight-line") versus how they are depreciated for
4 federal income tax purposes ("accelerated"). Accelerated depreciation does not change the total
5 taxes paid by the utility over time; it only changes the timing of income tax payments. Accrual of
6 deferred taxes is simply capturing the timing difference between straight-line and accelerated
7 depreciation. Deferred taxes are temporary, because they reverse over time. They are "*deferred"*
8 because the cash is received prior to when these taxes will be paid. Through this tool, the
9 Company and the Commission ensure taxes are recovered from customers fairly over the life of
10 the underlying asset, much in the same way that depreciation of plant occurs evenly over time.

11 During the time between when taxes are collected from customers, and when those taxes
12 are paid to the government, accumulated DFIT acts as a zero-cost source of capital[8] to the
13 Company, provided by ratepayers. Accumulated DFIT is accounted for as a reduction to rate base
14 for ratemaking purposes, conceptually similar to how customer deposits or contributions in aid of
15 construction are considered offsets to rate base.

16 These funds were collected under a presumption that future income taxes would be
17 incurred at the 35 percent corporate tax rate. However, as a result of the TCJA, future corporate
18 income taxes will only be assessed at the new reduced 21 percent rate.

19 **B. Excess DFIT related to the depreciation of plant**

20 *Excess* DFIT exists because the tax rate has been reduced. It is appropriate, reasonable,
21 fair, and just to return excess DFIT to customers, as excess DFIT represents the accumulated
22 amount of taxes customers have overpaid. However, the Commission should consider certain

[8] Some may argue that these funds are not zero-cost. Instead, the argument goes, the reduction to rate base implicitly

1 requirements from the IRS that the Company faces when considering how to return these funds
2 to customers.
3 Staff expects that Avista will calculate the excess DFIT based on DFIT balances as of
4 December 31, 2017. This excess amount will be removed from DFIT and placed into a regulatory
5 liability account. The net effect on rate base from this action would be zero, as regulatory
6 liabilities act as an offset to rate base, just as accumulated DFIT does. Excess taxes collected by
7 the Company since January 1, 2018 under existing rates will also be placed into the regulatory
8 liability account.
9 Section 13001(d)(1)[9] of the TCJA requires that, in order for the Company to be
10 considered to use a normalization method of accounting, it must not reduce "the excess tax
11 reserve more rapidly or to a greater extent than such reserve would be reduced under the average
12 rate assumption method." The Company must be considered to use a normalization method of
13 accounting in order to maintain eligibility for accelerated depreciation. Violating the average rate
14 assumption method ("ARAM") provision also comes with a penalty to the Company. These
15 requirements apply to the excess tax reserve associated with the depreciation of plant.
16 The practical effect is that the Company is restricted with respect to the pace of the return
17 of most excess taxes to customers. This is currently estimated to produce a 36 year amortization
18 schedule. It should be noted that the IRS does not *require* the Company to return excess DFIT to
19 customers; it simply restricts how quickly depreciation-related excess DFIT is returned to
20 customers.
21 Staff has confirmed through correspondence with the Company that Generally Accepted
22 Accounting Principles ("GAAP") requires the Company to amortize the excess tax reserve

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results in an interest rate equal to the authorized rate of return.

1 related to plant depreciation, effective January 1, 2018. Accordingly, the Company will amortize
2 the appropriate amount, reducing the balance of the aforementioned regulatory liability, and
3 increasing the balance of the account established under the deferred accounting petition. Over
4 time, the regulatory liability is reduced through amortization, which produces a larger rate base
5 balance as a result. It is unclear if this process will result in materially larger rate base balances
6 than it otherwise would have, as the DFIT balance would also be reduced as the Company made
7 future federal income tax payments.

8 The ARAM provision is applicable to excess tax reserves related to plant depreciation.
9 These funds are sometimes referred to as "protected" excess deferred taxes. Most, but not all,
10 excess DFIT is of this nature.

11 **C. Excess DFIT not related to the depreciation of plant**

12 The remaining "unprotected" excess DFIT does not appear to be restricted with respect to
13 the pace it is returned to customers, which provides for considerable discretion for the
14 Commission on this matter.

15 Excess DFIT that is not related to the depreciation of plant can arise from several sources.
16 Some examples are: a difference in the size of a particular capitalized asset,[10] or, expenses that
17 are not deductible for tax purposes but which are included for ratemaking purposes. Because
18 these items do not accrue DFIT due to life and method differences in the treatment of
19 depreciation, Staff sees no reason to require that the return of "unprotected" DFIT to ratepayers
20 should consider depreciation schedules.

[9] https://www.congress.gov/115/bills/hr1/BILLS-115hr1enr.pdf *See:* page 46.
[10] One reason such a difference in asset valuation may exist is if the Commission previously disallowed a portion of an asset's costs for recovery from ratepayers.

Instead, the excess "unprotected" DFIT should be returned to customers consistent with any IRS requirements. If no requirement exists, it should be returned to customers promptly. While intergenerational problems are unavoidable, a prompt return of "unprotected" excess DFIT best ensures that the customers who provided these excess funds are the customers that receive the return of them. An example of a prompt return of "unprotected" excess DFIT to customers would be a three year amortization schedule that coincides with a three year rate plan.

VII. THE TCJA'S IMPACT ON STAFF'S RATE PLAN

Aside from the changes discussed in Section V, "Determining tax expense going forward", Staff does not have any changes to its recommendation for a rate plan. The mechanics of the rate plan are still sound and appropriate under the new tax law. Staff's revenue requirement model for Years 2 and 3 of the rate plan will simply have to be updated to incorporate the Year 1 revenue requirement figure determined using the new revenue conversion factor.

VIII. SUMMARY

In summary, the effects of the changes to tax law can and should be captured in this general rate case.

Excess taxes as of December 31, 2017, should be calculated, removed from DFIT, and placed in a regulatory liability, which will have no effect on rate base. Most of these excess taxes will have to meet IRS standards with respect to the pace at which they are returned to customers.

An amortization schedule (or schedules) for excess taxes as of December 31, 2017, will be established. Amortization will result in a reduction of the regulatory liability's balance, and a corresponding increase in the balance of the deferred accounting mechanism the Company has petitioned for.

1 Excess taxes collected after December 31, 2017, will be placed in the deferred accounting
2 mechanism as well.
3 Any errors in implementing the TCJA (given the short timeframe in attempted to reflect
4 the new tax law in rates) can be trued-up through the deferred accounting mechanism, and after
5 the conclusion of this general rate case.
6 The Company will file a rebate tariff in dockets UE-171221 and UG-171222 that will
7 propose how to return excess taxes, now captured by the deferred accounting mechanism, to
8 customers.
9 Staff recommends the Commission:
10 1. Request that the Company provide the report of TCJA effects as soon as feasible and
11 allow the Parties to have at minimum four weeks to review and respond to that report;
12 2. As an alternative to No. 1, above, if Avista cannot provide the report early enough to
13 allow the Parties at least four weeks for review, the Commission should request the
14 Company voluntarily extend the suspension date in the current rate case such that
15 Parties will have at least a four week review period;
16 3. Approve the Company's deferred accounting petition in dockets UE-171221 and UG-
17 171222;
18 4. Reflect the ramifications of the new tax law in the revenue requirements produced as
19 a result of this general rate case, ensuring that customers receive the full benefit of
20 Avista's tax savings regardless of whether the lower corporate tax rate reduces the
21 Company's revenue requirement; and
22 5. Allow for a process that returns excess taxes as soon as possible but complies with
23 IRS regulations.