

MEMORANDUM

December 3, 2018

TO: Mark Vasconi, Director of Regulatory Services
Brian Thomas, Director of Policy Division

FROM: Tim Zawislak, Senior Regulatory Analyst
Sean Bennett, Regulatory Analyst
Jing Roth, Assistant Director Telecommunications

RE: Tax Cuts and Jobs Act (TCJA) Impact on Telecom ILECs

BACKGROUND

On December 22, 2017, the “Tax Cuts and Jobs Act” (TCJA) was signed into law by the President of the United States of America.¹ On January 8, 2018, the Washington Utilities and Transportation Commission (UTC) issued a news release, “*State regulators: Utilities must pass federal tax cut savings on to customers.*”² On January 12, 2018, UTC Staff issued information requests to all 25 incumbent local exchange companies (ILECs). Most companies filed initial responses by mid-February 2018, and all of the companies have provided updated responses as of September 24, 2018. The original requests and each company’s individual responses are available by a specific docket number³ for each company in the Commission’s Records Center’s “Cases” system.

Based on review of written responses and information, Staff has initiated several conference calls with company representatives to discuss and assess what information was useful and to work through timing issues due to interstate jurisdictional separations cost study allocation results. Supplemental responses were received from companies that may have initially estimated the allocations and then later provided more accurate information based on the actual studies for 2017.

Cooperation by the companies in responding to the information requests has been positive (notwithstanding some companies’ objections they still provided the relevant and necessary information throughout this process).

ANALYSIS

Staff has reviewed and analyzed the information provided by the companies.⁴ The Attachment to this memo presents the Washington *intrastate* excess deferred tax reserves (EDTRs) based on the companies’ responses to the information requests. Additionally, those amounts are also presented on an *annualized* percentage basis of gross intrastate operating revenue in the last

¹ Pub. L. No. 115-97, 131 Stat. 2054 (2017). <https://www.congress.gov/115/bills/hr/1/BILLS-115hr1enr.pdf>

² Commission News. <https://www.utc.wa.gov/aboutUs/Lists/News/DispForm.aspx?ID=495>

³ Dockets UT-180013, et al.

⁴ The Subchapter “S” Corporations’ (referred to in Attachment 1) members are liable only in their separate capacities (being treated as partners) for purposes of federal income tax returns. *See: 26 CFR 1.701-1 and 1.1361-1(a)(1).*

column of the Attachment which shows the relatively small impact that a uniform rate reduction would achieve if the Commission chose to mandate such a result (which Staff advocates against).

The results of Staff's broader analysis of the overall issue is that the TCJA will continue to provide benefits to telecommunications customers even if uniform rate reductions are not sought.

Nonetheless, even though intrastate telecommunications prices are not proposed to be reduced in a direct manner, indirect benefits should continue to accrue to Washington state customers. Some of these indirect benefits will a) reduce interstate wholesale rates for NECA-member companies, b) eventually decrease fees for federal universal service subsidies, and c) possibly even increase investment in capital expenditures that would otherwise not have been made absent the TCJA's passage. All other things being equal, this impact essentially also decreases the risk of rate instability and generally helps toward continued telecommunications service availability.

Staff's analysis in the Attachment focused on the excess deferred federal income *tax reserve* benefits. Although it is also true that the nominal tax rate for federal income *tax expense* has gone down to 21 percent⁵ effective January 1, 2018; the basis for telecommunications companies' intrastate rates have not been based on embedded cost of service for decades. In fact, many telecommunications services have been classified as competitive and some companies⁶ have alternative forms of regulation (AFOR) that treat them as if they were competitively classified companies. To the extent that prices have been capped (either through the competitive marketplace or through the operation of the urban price floor and reasonable comparability ceiling) telecommunications consumers in Washington have benefitted from stable, predictable, and fair prices; and will continue to do so given the vibrant market and regulatory protections already in place.

CONCLUSION

The indirect benefits of the TCJA should continue to be experienced by telecommunications customers in Washington state now and in the future as the enhanced competitive pressures of a more level playing field continue to create more and better choices at lower prices.

Attachment

⁵ NECA-member companies that are "S" Corporations *impute* federal income tax for purposes of interstate cost studies and ratemaking, where applicable; whether it be at the 21 percent rate in the future or at the other applicable rates that have been effective in the past. Analysis performed during the State Universal Communications Services review is considering the NECA imputed tax impacts as part of the total regulated rate of return even though it is *not a ratemaking exercise, per se*.

⁶ CenturyLink ILECs (of which there are five) all have an AFOR under Docket UT-130477 until January 9, 2021.

COMPANY NAME	CLASS	WASHINGTON	INTRASTATE	annualized percent of intrastate annual report revenue
		2017 Excess Deferred Tax Reserve	2017 Excess Deferred Tax Reserve	
1 Asotin Telephone Company (TDS)	"B"	2,655	1,526	0.2%
2 CenturyTel of Cowiche, Inc. (CenturyLink)	AFOR	8,172	5,581	0.1%
3 CenturyTel of Inter Island, Inc. (CenturyLink)	AFOR	1,952,878	1,360,961	3.3%
4 CenturyTel of Washington, Inc. (CenturyLink)	AFOR	12,514,925	8,721,651	2.7%
5 Ellensburg Telephone Company (FairPoint)	"B"	644,227	389,242	1.1%
6 Frontier Communications Northwest Inc.	"A"	(15,730,240)	(17,780,420)	-1.9%
7 Hat Island Telephone Company	"B"	"S" Corp	"S" Corp	n/a
8 Hood Canal Telephone Company	"B"	"S" Corp	"S" Corp	n/a
9 Inland Telephone Company	"B"	1,107,729	666,290	3.8%
10 Kalama Telephone Company (Scatter Creek)	"B"	(250,481)	(157,603)	-1.9%
11 Lewis River Telephone Company (TDS)	"B"	31,275	19,228	0.6%
12 Mashell Telecom (Rainier Connect)	"B"	(93,715)	(38,342)	-0.2%
13 McDaniel Telephone Company (TDS)	"B"	187,075	110,674	4.1%
14 Pend Oreille Telephone Company (RTI)	"B"	165,939	97,167	1.1%
15 Pioneer Telephone Company	"B"	233,120	150,500	3.9%
16 QWEST CORPORATION dba CenturyLink QC	AFOR	44,454,110	32,051,413	1.1%
17 Skyline Telecom, Inc.	"B"	28,588	16,579	5.4%
18 St. John Telephone Company	"B"	498,353	304,752	6.6%
19 Tenino Telephone Company (Scatter Creek)	"B"	(212,000)	(137,376)	-1.6%
20 Toledo Telephone Company	"B"	1,084,369	264,267	3.6%
21 United Telephone Company of the Northwest (CenturyLink)	AFOR	121,683	82,270	0.1%
22 Western Wahkiakum dba (Wahkiakum West)	"B"	672,251	478,777	5.5%
23 Westgate Communications (dba WeavTel)	"B"	"S" Corp	"S" Corp	n/a
24 Whidbey Telephone Company	"B"	"S" Corp	"S" Corp	n/a
25 YCOM Networks (FairPoint)	"B"	608,593	430,884	2.0%