

## **Ratemaking Proposal for Taxes on Pre-1981 Property**

The change that is proposed is to increase the amount of the flow through in the company's book tax provision such that the balance in the regulatory asset account is amortized over a reasonable period with a corresponding recovery in rates. The adjusted flow through, as shown on the exhibit, produces a change from the test period taxes of \$2,347,800 (system) and, when multiplied by the depreciation factor, is \$245,909 for Washington. Grossing up for taxes produces a revenue requirement of \$395,615. While it is straightforward to calculate the revenue requirement effect prospectively, evaluating the actual versus appropriate treatment retrospectively is vastly more complicated. As with any accounting, it would be the most satisfying if we were able to quantify the effects of flow-through amounts as used in all previous ratemaking, and then compare the billed amounts to those included in the company's income tax provision. This would resemble a tax tracker. In light of the difficulties that oppose such an analysis, namely lack of historic data, the more pragmatic approach is to treat past variances as among all the other variability in rate case level revenues and expenses versus actuals. This approach is upheld by the ratemaking method that had been in use in the 1980's and 1990's (and presumably in use before) where the provision was used as a starting point for taxes in determining revenue requirement, with changes made for various adjustments of other issues (rate base, expenses, etc.). The flow-through amount identified within the test period provision would therefore be included in the case. Over the years, as the flow-through amount changed due to the mix of new plant and different year tax depreciation rates, the flow through as included in rates would likewise change as a result of rate cases.

### **Depreciation**

In more recent years, the flow-through amount that could have been justified for use in the tax provision has been much higher than the amount of flow-through used in ratemaking. The flow-through included in the provision from 1997 was inexplicably low at \$635,000 as compared to what should have been approximately \$4 million. Consequently, the company filed rate cases that included the lower flow-through amount. Beginning in the late 1990's, then, ratepayers began to benefit from a lower than appropriate amount in rates. The company has matched that recovery by continuing to use the same amount in the calculation of its book tax provision. The consequence of using the lower amount is that the recovery is delayed to future years rather than during the useful life of the property.

The proposed corrected amount used in the calculation of the provision is \$5,021,000 as compared to \$635,000. The \$5 million amount is proposed so that the regulatory balance associated with the pre-81 assets is amortized over a 20-year period.

## **Removal Costs**

Likewise, removal costs have been flowed through for ratemaking, which while benefiting ratepayers in the near term, does not provide for the best possible matching of recovery to cost incurrence. The company has determined that the flow through methodology is not required for removal costs related to pre-81 assets. The proposal is to discontinue the flow through method and move to normalization for all future removal cost tax treatment. The amount of removal cost that has been in use for the calculation of the book provision is \$2,323,000, and the company's proposal is to discontinue the flow through method.