

1 **Q. Please state your name, business address and present position with**
2 **PacifiCorp (the Company).**

3 A. My name is Ryan Fuller and my business address is 825 NE Multnomah St., Suite
4 1900, Portland, OR 97062. My present position is Assistant Tax Director.

5 **Qualifications**

6 **Q. Please describe your educational and professional background.**

7 A. I graduated from the University of Idaho in 1997 with a Bachelor of Science
8 Degree in Accounting. I am a licensed CPA. Before joining the PacifiCorp tax
9 department in 2003, I worked in public accounting for six years, first with Talbot,
10 Korvola and Warwick LLP and then for PricewaterhouseCoopers LLP.

11 **Q. What are your responsibilities as Assistant Tax Director?**

12 A. My primary responsibilities include income tax accounting and providing support
13 for the income tax component of the Company's regulatory filings.

14 **Q. Have you testified in previous regulatory proceedings?**

15 A. Yes. I have previously testified on behalf of the Company in the states of Oregon
16 and Utah.

17 **Q. What is the purpose of your direct testimony?**

18 A. My direct testimony addresses the calculation of the income tax portion of the
19 Washington-allocated revenue requirement requested in this case. More
20 specifically:

- 21 • I provide background on the "repairs deduction," a temporary book-tax
22 difference associated with a recent change in accounting method for
23 income tax purposes.

- 1 • I explain the Company's proposal for fully reflecting the benefits of
2 the repairs deduction in this case, and propose establishment of a
3 regulatory asset or liability for interest paid to or received from the
4 Internal Revenue Service (the Service) on adjustments made to the
5 repairs deductions taken in the Company's 2008 and 2009 federal
6 income tax returns.
- 7 • I sponsor the Company's proposal to fully normalize the repairs
8 deduction and all other temporary book-tax differences, with the
9 exception of the equity allowance for funds used during construction
10 (equity AFUDC).

11 **Q. Please explain the repairs deduction.**

12 A. Generally, the repairs deduction permits a taxpayer to take a tax deduction for
13 qualifying expenditures in the taxable year paid or incurred even though the same
14 expenditures are required to be capitalized and depreciated for book purposes. An
15 illustrative example of the new method of accounting is provided in confidential
16 Exhibit No.____(RF-2C).

17 For the Company, the repairs deduction is a change in accounting method
18 that required approval from the Service. The change in accounting method is
19 applicable for income tax purposes only and does not impact the methods of
20 accounting used for FERC or U.S. GAAP reporting purposes. Prior to the change
21 in accounting method, the Company was generally capitalizing these costs in
22 accordance with FERC accounting classifications and U. S. GAAP methods of
23 accounting. The costs were then subject to accelerated tax depreciation.

1 On December 30, 2008, the Company filed applications with the Service
2 for the change in accounting method (Form 3115). On October 2, 2009, and
3 October 7, 2009, the Service granted the Company permission to change its
4 method of accounting beginning with the taxable year beginning January 1, 2008.

5 **Q. Has the Company reflected the repairs deduction in its 2008 federal income**
6 **tax return?**

7 A. Yes. The Company's 2008 federal income tax return contains a repairs deduction
8 for the taxable year ended December 31, 2008, and a one-time adjustment (tax
9 deduction) known as an Internal Revenue Code (IRC) Section 481(a) adjustment.
10 IRC Section 481(a) adjustments are meant to prevent amounts from being
11 duplicated or omitted in transition from the old method of accounting to the new
12 method of accounting and are generally determined as if the new method of
13 accounting had always been used. The Company's IRC Section 481(a)
14 adjustment encompasses the taxable years ended November 30, 1999, through
15 December 31, 2007. Confidential Exhibit No.____(RF-3C) provides a summary of
16 the IRC Section 481(a) adjustment by year and the 2008 repairs deduction as
17 taken in the 2008 federal income tax return.

18 **Q. Does the Company intend to reflect the repairs deduction in its 2009 federal**
19 **income tax return?**

20 A. Yes. Beginning with taxable year beginning January 1, 2008, the repairs
21 deduction is the Company's ongoing method of accounting for qualifying
22 expenditures. Accordingly, to the extent the Company incurs qualifying
23 expenditures, a repairs deduction will be taken in the Company's federal income

1 tax return for the respective tax year. Confidential Exhibit No.____(RF-3C)
2 provides the 2009 repairs deduction estimated to be taken in the Company's 2009
3 federal income tax return.

4 **Q. Can you please illustrate how an IRC Section 481(a) adjustment operates?**

5 A. Yes. As a simple example, assume a company that uses the accrual basis of
6 accounting for both book and tax purposes accrues a \$1,000 liability and related
7 expense in year 1 and, in year 2, the company makes a cash payment to satisfy the
8 recorded liability. Under the accrual basis of accounting, the company is entitled
9 to a tax deduction in the year the expenditure is accrued. Accordingly, the
10 company would take a \$1,000 tax deduction in year 1. Now, assume that for
11 income tax purposes only, the company changes to the cash basis of accounting in
12 year 2. Under the cash basis of accounting, the company is entitled to a tax
13 deduction in the year the expenditure is paid. Accordingly, the company would
14 take another \$1,000 tax deduction in year 2 for the same expenditure it deducted
15 in year 1. However, in this example, the company would be required to record an
16 IRC Section 481(a) adjustment increasing taxable income by \$1,000 in the year of
17 change, year 2, preventing the duplication. This example is illustrated in Exhibit
18 No.____(RF-4).

19 **Q. What is the status of PacifiCorp's repairs deduction with the Service?**

20 A. To date, the Service has only granted the Company permission to change its
21 method of accounting beginning with the taxable year beginning January 1, 2008.
22 The amount of the IRC Section 481(a) adjustment and the 2008 repairs deduction
23 taken as a deduction in the Company's 2008 federal income tax return is still

1 subject to adjustment by the Service upon examination. The amount that will
2 ultimately be sustained upon examination is still uncertain.

3 **Q. How has the Company proposed to treat the repairs deduction in this filing?**

4 A. Assuming the Commission determines that the repairs deduction is sufficiently
5 known and measurable to be included in rates in this case, the Company proposes
6 to reflect the repairs deduction in a manner that also addresses its non-final nature.

7 First, as discussed below, the Company has reflected the full value of the repairs
8 deductions taken or expected to be taken through December 31, 2009, in this rate
9 case through a reduction in rate base which will be adjusted if necessary after the

10 Service has completed its examination of these repairs deductions and they are

11 final. Second, the Company respectfully requests that the Commission approve

12 the establishment of a regulatory asset or liability for the recovery of interest paid

13 to or received from the Service, if any, for adjustments made to the repairs

14 deductions taken in the Company's 2008 and 2009 federal income tax returns.

15 Authorizing this one-time recovery will hold both the Company and customers

16 harmless for the uncertainty of the repairs deductions reflected in this case.

17 **Q. What is the impact of the repairs deduction on revenue requirement in this
18 case?**

19 A. The Company has reflected the temporary book-tax difference created by the
20 repairs deduction on a normalized basis, meaning that customers benefit from the
21 accumulated deferred income tax liability generated by the repairs deduction by
22 way of a rate base reduction. As enumerated in Exhibit No.____(RF-5), the rate
23 base reduction reduces revenue requirement by \$1.7 million.

1 **Q. Please explain how the Company has treated all other temporary book-tax**
2 **differences in this filing.**

3 A. Consistent with the treatment of the repairs deduction, the Company has reflected
4 all other temporary book-tax differences on a normalized basis, with the single
5 exception of the temporary book-tax difference associated with the equity
6 AFUDC. In prior rate cases, the Company reflected all temporary book-tax
7 differences not required to be normalized by the IRC on a flow-through basis. As
8 enumerated in Exhibit No.____(RF-6), reporting all temporary book-tax
9 differences on a normalized basis, other than the temporary book-tax difference
10 associated with equity AFUDC, reduces revenue requirement by \$25,891 as
11 compared to reporting these same book-tax differences on a flow-through basis.

12 **Q. Is the Company proposing to move to full normalization in this rate case? If**
13 **yes, why?**

14 A. Yes, the Company is proposing to move to the fully normalized treatment of
15 income taxes. There are practical and policy reasons underlying this proposal. As
16 a practical matter, the Company's income taxes are normalized in Oregon, Utah,
17 and Wyoming, which account for approximately 85 percent of the Company's
18 total regulated operations. The Company is also pursuing this treatment in
19 California and Idaho. Ideally, the Company would have a single and consistent
20 policy across all of its regulated operations which would provide benefits by way
21 of increased efficiency in the Company's income tax accounting and reporting
22 processes and income tax accounting systems.

23 As a policy matter, the Company supports tax normalization based on the

1 matching principle and intergenerational equity. Tax normalization matches tax
2 benefits with cost responsibility and prevents customers who pay for the cost of
3 an asset well past its tax life from paying a disproportionately higher tax rate than
4 customers that pay for the same asset during its tax life. Because tax
5 normalization matches tax benefits with cost responsibility, all customers pay the
6 same effective tax rate over the asset's entire life.

7 **Q. Does the repairs deduction illustrate the policy reasons supporting the**
8 **Company's proposal to normalize all temporary book-tax differences?**

9 A. Yes. Under the flow-through treatment of the repairs deduction, there are
10 significant out-of-period issues with respect to the IRC Section 481(a) adjustment
11 and the 2008 repairs deduction. As enumerated in Exhibit No.__(RF-7), under
12 flow-through accounting, 85 percent of the tax benefits from the repairs deduction
13 (\$25.3 million of the total of \$29.6 million in Washington-allocated tax benefits
14 generated through the taxable year ended December 31, 2009), would be
15 considered out-of-period. In contrast, under the Company's proposal for full
16 normalization, customers receive all of the tax benefits of the repairs deduction.
17 This demonstrates how tax normalization creates a more balanced outcome
18 between the Company and its customers.

19 **Q. Why doesn't the Company propose to normalize the repairs deduction only**
20 **and continue flow-through treatment for all other temporary book-tax**
21 **differences?**

22 A. The Company does not support the selective determination of normalization or
23 flow-through treatment for each temporary book-tax difference. This approach

1 does not satisfy the practical and policy considerations discussed above.
2 Additionally, a policy of selective determination of the regulatory treatment of
3 individual temporary book-tax differences creates uncertainty as to the correct
4 accounting treatment of the deferred income taxes generated by the Company's
5 temporary book-tax differences for SEC and FERC financial reporting purposes
6 and subjects the Company to the possibility of prior period adjustments to its
7 earnings if the incorrect regulatory treatment is assumed.

8 Accordingly, with the normalization of the repairs deduction, the
9 Company has also normalized all other temporary book-tax differences, with the
10 single exception of the temporary book-tax difference associated with equity
11 AFUDC. This is consistent with how the Company accounts for temporary book-
12 tax differences in other states and establishes an ongoing regulatory policy for the
13 treatment of income taxes for the Company in Washington that is balanced and
14 consistent.

15 **Q. Does the Company recommend adoption of tax normalization for**
16 **PacifiCorp?**

17 A. Yes. The Company respectfully requests that the Commission authorize the
18 Company to henceforth account for Washington-allocated income taxes not
19 currently normalized on a fully normalized basis beginning January 1, 2011.

20 **Q. Why is the Company proposing to exempt the temporary book-tax difference**
21 **related to equity AFUDC from its proposal for full normalization?**

22 A. The Company has reviewed the income tax normalization policy for equity
23 AFUDC and has determined that, because equity AFUDC more closely resembles

1 a permanent difference for ratemaking purposes, an income tax flow-through
2 policy is more appropriate than normalization.

3 Equity AFUDC increases the book basis of assets. It originates as book
4 income and reverses as an expense through book depreciation. Over the book life
5 of the related asset, equity AFUDC has no net impact on book income. Equity
6 AFUDC also has no impact on taxable income because the income created by
7 equity AFUDC is never taxable and the book depreciation attributable to equity
8 AFUDC is never deductible for income tax purposes. Items of book income or
9 expense that are never taxable or never deductible for income tax purposes are
10 typically considered permanent book-tax differences for income tax accounting
11 purposes. Permanent book-tax differences do not generate deferred income tax
12 expense because there is no corresponding future event that will generate a tax
13 receivable or payable on an income tax return.

14 However, because of the unique “in-and-out” aspect of equity AFUDC for
15 book purposes, accounting guidance recommends that equity AFUDC be tracked
16 as a temporary book-tax difference for income tax accounting purposes. Equity
17 AFUDC is a temporary book-tax difference in the sense that it ultimately has the
18 same impact on book income and taxable income – zero. For income tax
19 accounting purposes, the temporary book-tax difference for equity AFUDC
20 generates deferred income tax liability upon origination, with a corresponding
21 debit to deferred income tax expense. As the temporary book-tax difference
22 reverses over the book life of the related asset, the income tax accounting entry is
23 to debit the deferred income tax liability and credit deferred income tax expense

1 until the deferred income tax liability is brought down to zero.

2 Accordingly, because deferred income taxes are included in revenue
3 requirement under a policy of income tax normalization, normalization of this
4 item in rates effectively results in a loan to the Company from customers that is
5 returned to them over time with interest at the Company's rate of return with no
6 tax impacts or payments to the Service. Under flow-through accounting, the
7 deferred income taxes generated by equity AFUDC never impact revenue
8 requirement, which is appropriate since there is no corresponding income tax
9 payable or receivable between the Company and the Service.

10 Currently, the Company uses flow-through accounting for the deferred
11 income taxes generated by equity AFUDC in all of its regulatory jurisdictions,
12 including those regulatory jurisdictions that have adopted a policy of income tax
13 normalization.

14 **Q. Are there any other implementation issues raised by PacifiCorp's proposal to**
15 **move to full normalization?**

16 A. Yes. To implement full normalization, the Commission will ultimately need to
17 address the disposition of a regulatory asset associated with income tax flow-
18 through in Washington for non-property related temporary book-differences.
19 However, because the Company is proposing to use flow-through accounting for
20 Washington-allocated income taxes through December 31, 2010, the Company
21 proposes to address the recovery of the regulatory asset for flow-through on non-
22 property related temporary book-tax differences in the next filed rate case, at

1 which time the final regulatory asset or regulatory liability will have been
2 determined.

3 **Q. Does this conclude your direct testimony?**

4 **A. Yes.**