

**BEFORE THE
WASHINGTON UTILITIES & TRANSPORTATION COMMISSION**

In the Matter of the Petition of
PUGET SOUND ENERGY, INC.

For an Accounting Order Authorizing Deferral
and Recovery of Interest Due the Internal
Revenue Service for Tax Years 2001 to 2006
Along with Carrying Costs Incurred in
Connection with the Interest Due

Docket No. UE-08 _____
Docket No. UG-08 _____

PETITION OF
PUGET SOUND ENERGY, INC.
FOR AN ACCOUNTING ORDER

I. INTRODUCTION

1. In accordance with WAC 480-07-370(b), Puget Sound Energy, Inc. ("PSE" or the "Company") respectfully petitions the Commission to issue an Order supplemental to the order issued in Docket Nos. UE-051527 and UG-051528, authorizing the deferral and recovery of net interest due the Internal Revenue Service ("IRS") for tax years 2001-2006 along with carrying costs incurred in connection with the interest due, using the Company's allowed net of tax rate of return (currently 7.00%).

2. PSE is engaged in the business of providing electric and gas service within the State of Washington as a public service company, and is subject to the regulatory authority of the

Commission as to its retail rates, service, facilities and practices. Its full name and mailing address are:

Puget Sound Energy, Inc.
Attn: Karl Karzmar,
Director, Regulatory Relations
P.O. Box 97034
Bellevue, Washington 98009-9734

3. Rules and statutes that may be brought at issue in this Petition include RCW 80.01.040, RCW 80.28.020, and WAC 480-07-370(b).

II. BACKGROUND

4. On October 26, 2005, the Commission issued Order No. 1 in Dockets UE-051527 and UG-051528 ("Order No. 1") authorizing deferral and recovery of costs associated with increased borrowings necessary to remit deferred taxes to the IRS. The deferred taxes related to adoption of an accounting method that PSE and many other utilities made in 2001 to adopt the simplified service cost method ("SSC method") under §263A of the Internal Revenue Code. On August 2, 2005, the IRS issued Revenue Ruling 2005-53 ("RR 2005-53") and compatible regulations that significantly and adversely impacted utilities that availed themselves of the simplified service cost method. The IRS required PSE to repay the deferred taxes pursuant to Regulation §§1.263A-1T and 1.263A-2T, which provided that taxpayers using the SSC method must adopt a less advantageous accounting method in 2005. The unfavorable tax impact of the accounting method change could then be spread over the next two tax years (2005 and 2006). The regulations postponed determination of the appropriateness of using the SSC method by

utilities or the amount of interest or penalties related to the change in accounting method to a later date. Order No. 1 approved the deferral of financing costs on the repayment of the original tax benefits, which at the time did not include consideration of interest on the accounting method change.

5. After Order No. 1 was issued, the IRS examination team audited the Company's original accounting method change to adopt the SSC method. The IRS examination team disallowed the Company's tax benefit for deferred taxes in full based on RR 2005-53. The Company appealed the IRS disallowance.

6. During 2006, PSE and other utilities across the country engaged in settlement discussions with the IRS while appealing the blanket disallowance of the SSC method. In response, the IRS developed nation-wide settlement guidelines. When applied to PSE's situation, the guidelines resulted in reinstatement of about 85% of the original benefit claimed.

7. The results of the IRS settlement offer are shown in Table 1.

Table 1: Comparison of Original Tax Returns with the Final IRS Settlement

	Original tax returns	IRS Settlement	Change	Tax @ 35%
2001	(186,448,716)	(128,185,063)	58,263,653	20,392,279
2002	(11,932,922)	(13,666,029)	(1,733,107)	(606,587)
2003	(5,603,580)	(9,722,765)	(4,119,185)	(1,441,715)
2004	14,480,256	(7,112,065)	(21,592,321)	(7,557,312)
2005	94,759,474	79,349,949	(15,409,525)	(5,393,334)
2006	94,745,488	79,335,973	(15,409,515)	(5,393,330)
Total	0	0	0	0

8. Under the settlement guidelines, the Company reported a smaller tax deduction in 2001. However, in every year after 2001, the Company reported larger tax deductions. Under the settlement guidelines, as with the original tax returns, the Company must roll off of the SSC method as provided under the regulations. The impact of this accounting change causes the total amount of the tax adjustments to equal zero.

9. As a result of the IRS settlement with PSE, the Company will owe interest on the 2001 tax payment due. This interest payment will be partially offset by the interest income on IRS refunds due for tax years 2002 through 2006. Through September 30, 2008, the net interest due to the IRS is estimated to be \$6.8 million as shown in the table below:

	Tax	Interest
Payment 2001	\$20,392,279	\$9,933,056
Refunds 2002-2006	(\$20,392,279)	<u>(\$3,124,062)</u>
Estimated Net Interest		<u>\$6,808,994</u>

10. In Order No. 1, the Commission declined to prejudge this interest issue before it was actually finalized. However, the Commission recognized that it would be appropriate for the Company to file for rate treatment in the event that interest was assessed by the IRS:

We cannot lawfully prejudge future rates. However, we do find it appropriate to recognize in principle that if the IRS successfully challenges in court the adjustment PSE and other utilities have taken, and requires future repayment of the current benefits taken, presumably with interest, PSE should file an accounting petition asking for appropriate treatment of any back taxes and interest assessed.

Order No. 1 at ¶ 4 (quoting *WUTC v. PSE*, Docket No. UG-040640 *et al.*, Order No. 6 ¶ 159 (Feb. 18, 2005) (quotations omitted)).

11. PSE will be required to remit the estimated \$6.8 million in net interest due the IRS. PSE, therefore, seeks in this filing to establish a deferred account that will accumulate the interest due to and from the IRS along with carrying costs on the deferred interest balance.

III. PROPOSED ACCOUNTING AND RATEMAKING TREATMENT

12. The Company proposes to defer to FERC Account No. 182.3, Other Regulatory Assets, the interest of \$9.9 million that is now due to the IRS along with the increased borrowings necessary to remit the interest due. The deferred amounts would be apportioned to electric and gas operations, 59.1% and 40.9 %, respectively based on how costs from both electric and gas operations contributed to the actual tax deduction.

13. In addition to the deferral of the interest payment due to the IRS, the Company would also book the interest income as received from the IRS and accrue monthly carrying costs associated with the total deferrals, apportioned as previously discussed. The carrying costs would be equivalent to PSE's authorized net of tax rate of return for the period, 7.00% per the Partial Settlement Re: Electric and Natural Gas Revenue Requirements and Order 12 in the Company's most recent general rate case, Docket No. UE-072300 *et al.*, commencing December 1, 2008, and ending with the effective date of new rates going into effect as a result of the Commission's order in the Company's next general rate case.

14. Consistent with amortization provided for in Docket Nos. UE-051527 and UG-051528, PSE proposes that such deferred amounts, including accrued carrying costs, should then be amortized over two years in account 407.3, Regulatory Debits. Such amortization should commence as of the earlier of July 1, 2010, or when new rates go into effect as a result of the Company's next general rate case, to be filed subsequent to April 1, 2009. PSE further proposes that in its next general rate case, when final amortization amounts are confirmed and new rates are set to begin, the deferral amount plus accrued carrying costs shall be included in ratebase and deferral of carrying costs will cease.

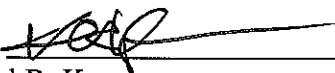
15. Any deferred taxes arising from the deferral of net interest and carrying costs shall be treated in the same manner as the proposed deferral for regulatory purposes including accruing interest at the Company's net of tax rate.

IV. PRAYER FOR RELIEF

16. Based on the foregoing, PSE respectfully requests that the Commission issue an Accounting Order in the form attached as Exhibit A.

DATED this 5th day of November 2008.

PUGET SOUND ENERGY, INC.

By 


Karl R. Karzmar
Director, Regulatory Relations

VERIFICATION

STATE OF WASHINGTON)
) ss.
COUNTY OF KING)

Karl Karzmar, being first duly sworn, on oath deposes and says:


That he is Director of Regulatory Relations with Puget Sound Energy, Inc., that he has read the foregoing Petition of Puget Sound Energy, Inc. for An Accounting Order, that he knows the contents thereof, and that he believes the same to be true to the best of his knowledge and belief.



Karl R. Karzmar

SUBSCRIBED and SWORN to before me this 5th day of November 2008.




Print Name: DENISE K SCHROEDER
Notary Public in and for the State of Washington,
residing at SNOQUALMIE WA
My commission expires: 8-1-09