Allocation of Taxes Related to Book and Tax Depreciation

BACKGROUND

When the Company files a rate case, the test year rate base includes accumulated deferred income taxes related to book and tax depreciation. That component is composed of the base year ending balance plus the amount developed in the forecasted period between the end of the base year and the end of the test year. A beginning/ending average is then calculated to arrive at the balance included in the test year. The discussion below pertains to the amount that is developed during the forecasted period and will be referred to as DADIT (Depreciation Accumulated Deferred Income Tax). Also included in the Company's filed test year are Schedule M items, deferred tax benefits and deferred tax expenses related to book and tax depreciation. These income statement items will be referred to as DITMEB (Deferred Income Tax, Schedule M, Expense, Benefit). The discussion below only pertains to the DITMEB amount developed for the 12 months of the test year. Def Tax Factors tab of Attachment C should be useful in following the discussion below.

DADIT is a material component of the Company's revenue requirement[1]. The chart below shows the revenue requirement components that are affected by book and tax depreciation as well as the associated FERC accounts.

Depreciation Type	Revenue Requirement Component	FERC Acct
Tax Depreciation	Deferred Tax Expense	41010
	Taxable Income (Sched M Ded - Temporary)	N/A
	Accum Def Income Tax Liability (Rate Base Deduction)	282

Depreciation Type	Revenue Requirement Component	FERC Acct
Book Depreciation	Deferred Tax Benefit	41110
	Taxable Income (Sched M Add - Temporary)	N/A
	Accum Def Income Tax Asset (Rate Base Addition)	282

ANALYSIS

In the 2009 general rate case, the DADIT and DITMEB items at the jurisdictional level were allocated based on each jurisdiction's share of book or tax depreciation. At the functional level most of the DADIT and DITMEB items were allocated based on the same concept- each function's share of book and tax depreciation. The exceptions were FERC 41110 and FERC 282 (related to book depreciation). These two accounts were allocated based on each function's share of gross plant. At the class level, the DADIT and

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[1]In the original filing in Docket No. 09-035-23 the DADIT (combination of book and tax) reduced total Company rate base by approximately $382 million. This had the effect of reducing Utah's revenue requirement by approximately $18.6 million. Since revenue requirement consists of deferred income tax expense plus current income tax expense the net effect of the DITMEB items at the Utah jurisdictional level is zero. This is because the deferred income tax expense items "cancel out" or "zero out" the Schedule M items.

DITMEB components were allocated based on each class' share of rate base or net plant[2]. There are therefore inconsistencies with how these deferred taxes are being allocated at the JAM level and COS (functional and class) level. Embedded in this inconsistency is also the fact that the Schedule M amounts and deferred income tax benefit amounts related to book depreciation do not currently share the same allocation factors at the functional level. In theory, the Schedule M amounts should "cancel out" the deferred income tax benefit amounts, thus having no effect on revenue requirement. This is currently not allowed to happen at the functional or class level since both (Schedule M and Deferred income tax benefit) amounts use different allocation factors.

<u>RECCOMENDATION</u>
The Division believes that the DADIT and DITMEB components should be allocated at all levels similar to the method currently used at the JAM level. In other words, each jurisdiction, function and class should be allocated these deferred tax components based on their respective share of book and/or tax depreciation. This change is not being proposed just for purposes of aligning the COS model to the JAM model. These deferred and current tax components originate from book and tax depreciation. It would therefore seem reasonable to allocate them at each level (jurisdiction, function, class) based on the respective share of book and/or tax depreciation. It is also proposed that the DITMEB items be allocated using the same allocation factor within each level (jurisdiction, function, class). As mentioned above in the analysis section, this will enable the deferred income tax expense and Schedule M items to "cancel out" each other so there is no effect on revenue requirement. A comparison of what was used by the Company in Docket No. 09-035-23 and what the Division is now proposing can be found in Def Tax Factors tab of Attachment C. This tab shows a proposed "DEPS" (Depreciation by Schedule) factor being used at the class level to allocate the deferred and current tax components. An example of how this factor would be calculated is shown in the DEPS Calculation tab of Attachment C. Although not shown in the tab, a DEPS factor would also be calculated at the functional level. The DEPS Calculation tab shows the impact on the classes of using the DEPS factor. We believe the DEPS factor makes the COS model more consistent with JAM and, more importantly, allocates theses deferred tax components based on their direct driver which is book and tax depreciation.

The inconsistent treatment of DADIT and DITMEB items were first brought to the attention of the parties during our second to last workgroup meeting. Before the last workgroup meeting a spreadsheet showing the Division's proposal concerning these tax issues was sent to the various parties. During the last meeting, the discussion revolved around the Company's anticipated move to Rolled-In and more specifically how that effected the group's analysis of the JAM and COS inconsistencies. As a result, the Division's proposal concerning the allocation of these tax items was not discussed.

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[2] Note: Taxable income was not calculated at the class level in Docket 09-035-23 and therefore the Schedule M Additions and Deductions were not allocated at the class level. As a result of the Commission's order in that docket, taxable income is now calculated at the class level.