State of Utah
Department of Commerce
Division of Public Utilities

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ACTION REQUEST RESPONSE

TO: Public Service Commission

FROM: Division of Public Utilities:
Chris Parker, Director
William Duncan, Telecommunications Manager
Gary Smith, Utility Analyst

DATE: March 30, 2018

RE: Docket Nos. 17-2201-01, 17-040-01, 17-2180-01, 17-043-01, 17-2303-02, 17-576-01, 17-053-01, 17-054-01, 17-2419-01, 17-2302-02, 17-052-02, 17-046-01, and 17-042-02

Investigation of Revenue Requirement Impacts of the New Federal Tax Legislation Titled: "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution of the budget for fiscal year 2018"

RECOMMENDATION (Defer for future consideration)

The Division of Public Utilities ("Division") recommends the Public Service Commission ("Commission") defer, for future treatment, the effects of federal tax legislation recently passed by Congress. ("Tax Act"). Given that there is likely to be some effect on companies receiving state funding, either in expenses or the treatment of deferred income taxes, the Commission should preserve its ability to address those effects in future proceedings for the relevant companies.

BACKGROUND AND DISCUSSION

On December 22, 2017, President Trump signed the Tax Act into law, which made significant changes to the tax code. In particular, the federal corporate income tax rate was reduced from 35% to 21%. This reduction in the tax rate has two significant impacts: First, it reduces the Company's federal income tax expense effective January 1, 2018, and second, it reduces the deferred income tax liability, accounted for on the Company's balance sheet as Accumulated Deferred Income Taxes or ADIT.

On December 21, 2017, the Commission issued a Notice of Comment Period concerning the utilities under these dockets to investigate and describe in detail the revenue requirement impacts of the Tax Act. Responses were due by January 31, 2018. On February 2, 2018, the Commission issued an Order to Show Cause by February 27, 2018 why each of the following public utilities ("the Utilities") had not responded:

Bear Lake Communications, Inc. (17-2201-01)
Central Utah Telephone, Inc. (17-040-01)
All West Communications, Inc. (17-2180-01)
Gunnison Telephone Company (17-043-01)
Hanksville Telcom, Inc. (17-2303-02)
Skyline Telecom (17-576-01)
STRATA Networks (UBTA-UBET Communications, Inc.) (17-053-01)
Union Telephone Company (17-054-01)
Direct Communications Cedar Valley, LLC (17-2419-01)
Carbon/Emery Telcom, Inc. (17-2302-02)
South Central Utah Telephone Association, Inc. (17-052-02)
Manti Telephone Company (17-046-01)
Emery Telephone (17-042-02)

On or before February 27, 2018, the Utilities filed comments regarding the effects of the Tax Act on its revenue requirement. Their responses fell into three groups.

1) Those that are non-profits whose revenue requirement will not be affected by changes in the Tax Act. This group included the following:

STRATA Networks (UBTA-UBET Communications, Inc.) (17-053-01)
South Central Utah Telephone Association, Inc. (17-052-02)
Emery Telephone (17-042-02)

2) Those that believe the reduction of the tax rates and the removal of the graduated tax rates will not make a significant change in their tax obligation. This group made no mention of impact of the Tax Act on their ADIT. This group was comprised of:

Gunnison Telephone Company (17-043-01)

3) Those that believe their ADIT liability will be overstated and will need to be adjusted. This group comprised the following:

Bear Lake Communications, Inc. (17-2201-01)
Central Utah Telephone, Inc. (17-040-01)
All West Communications, Inc. (17-2180-01)
Hanksville Telcom, Inc. (17-2303-02)
Skyline Telecom (17-576-01)
Union Telephone Company (17-054-01)
Direct Communications Cedar Valley, LLC (17-2419-01)
Carbon/Emery Telcom, Inc. (17-2302-02)
Manti Telephone Company (17-046-01)

Groups 2 and 3 above also requested that any evaluation of revenue requirement be made taking into consideration all relevant changes, including the changes associated with the Tax Act, changes to Utah Code 54-8b-15, and newly enacted and proposed administrative rule changes.

DPU's COMMENTS

One of the impacts of the Tax Act is that ADIT will be reduced by the difference between the existing balance of ADIT and the recalculated balance under the new 21% tax rate. This difference is the Excess Deferred Income Taxes, or EDIT. Under the Tax Act, a normalization method of accounting must be used to amortize EDIT over the original life of the underlying assets for public utility property. The primary method provided in the Tax Act is the Average Rate Assumption

Method, or ARAM[1]. The attached Exhibit 1 is the example ARAM calculation taken from page 345 of the Conference Report of the Tax Act. Exhibit 1A is an excel spreadsheet the Division created to review of the ARAM calculation from Exhibit 1.

The Tax Act also allows a utility that does not have the data necessary to compute ARAM to use a simplified alternative method of reducing excess deferred tax reserves, if, as of the first day of the taxable year, which includes December 22, 2017, the utility (i) computes depreciation of public utility property on the basis of an average life or composite rate method and (ii) keeps underlying books and records that do not contain the vintage account data necessary to apply ARAM. ARAM requires amortization of the excess tax reserve over the remaining regulatory lives of the property that gave rise to the reserve for deferred taxes. The permitted alternative method computes the excess tax reserve on all public utility property based on the weighted average life or composite rate used to compute depreciation for regulatory purposes and reduces the excess tax reserve ratably over the remaining regulatory life of the property.

The Division agrees that the evaluation of the revenue requirement should include the changes resulting from the Tax Act, Utah Code 54-8b-15, and administrative rules. The proposed depreciation-related administrative rule changes would not impact the total calculated EDIT of the Utilities, but could impact the book depreciation, which would impact the ARAM normalization calculation and the timing of the return of EDIT reserves to rate payers.

CONCLUSION

The Division recommends the Commission defer for future treatment the effects on revenue requirement resulting from the Tax Act. Those effects could be addressed after the current rule making regarding depreciation expense is resolved. The Division further recommends allowing the Utilities time to calculate and quantify the impacts on revenue requirement as well as the

[1] "H.R.1 - An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018." Accessed February 14, 2018. Section 1561(d). https://www.congress.gov/bill/115th-congress/house-bill/1/text

mechanism for redressing any associated imbalance in customer rates or state funding. The Division requests the opportunity to address any issues that arise in those individual cases.

cc: Michele Beck, Committee of Consumer Services