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and its Members

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

2019 Utah Universal Service Fund Preliminary Recommendation for Central Utah Telephone, Inc.	DOCKET NO. 18-040-01
2019 Utah Universal Service Fund Recommendation for Emery Telephone	DOCKET NO. 18-042-01
2019 Utah Universal Service Fund Preliminary Recommendation for Gunnison Telephone Company	DOCKET NO. 18-043-01
2019 Utah Universal Service Fund Recommendation for Manti Telephone Company	DOCKET NO. 18-046-01
2019 Utah Universal Service Fund Preliminary Recommendation for Beehive Telephone Company, Inc.	DOCKET NO. 18-051-01
2019 Utah Universal Service Fund Recommendation for South Central Utah Telephone Association, Inc.	DOCKET NO. 18-052-01
2019 Utah Universal Service Fund Recommendation for UBTA-UBET Communications, Inc. dba Strata Networks	DOCKET NO. 18-053-02

2019 Utah Universal Service Fund Recommendation for Union Telephone Company	DOCKET NO. 18-054-01
2019 Utah Universal Service Fund Preliminary Recommendation for Skyline Telecom	DOCKET NO. 18-576-01
2019 Utah Universal Service Fund Recommendation for All West Communications, Inc.	DOCKET NO. 18-2180-01
2019 Utah Universal Service Fund Preliminary Recommendation for Bear Lake Communications, Inc.	DOCKET NO. 18-2201-01
2019 Utah Universal Service Fund Recommendation for Carbon/Emery Telcom, Inc.	DOCKET NO. 18-2302-02
2019 Utah Universal Service Fund Recommendation for Hanksville Telcom, Inc.	DOCKET NO. 18-2303-01
2019 Utah Universal Service Fund Preliminary Recommendation for Direct Communications Cedar Valley, LLC	DOCKET NO. 18-2419-01
	JOINT STIPULATION AND SETTLEMENT AGREEMENT

STIPULATION AND SETTLEMENT AGREEMENT

The Utah Rural Telecom Association (“URTA”), on behalf of itself and URTA members,[1] the Division of Public Utilities ("DPU"), and the Office of Consumer Services ("OCS") (collectively the "Stipulating Parties" or the "Parties"), through their undersigned representatives, enter into this Stipulation and Settlement Agreement ("Stipulation") regarding the Recommendations for UUSF Disbursements filed in the above referenced dockets. The Parties submit this Stipulation for approval

[1] All West Communications, Inc., Bear Lake Communications, Inc., Beehive Telephone Company, Carbon/Emery Telcom, Inc., Central Utah Telephone, Inc., Direct Communications Cedar Valley, LLC, Emery Telephone, Gunnison Telephone Company, Hanksville Telcom, Inc., Manti Telephone Company, Skyline Telecom, South Central Utah Telephone Association, Inc., UBTA-UBET Communications, Inc. dba Strata Networks, and Union Telephone Company (“Members” or “URTA Members”).

by the Public Service Commission of Utah (the "Commission" or the "PSC") pursuant to the Public Service Commission Administrative Code, Rule R746-1.

PRELIMINARY STATEMENT

1. On October 4, 2018, the Division filed preliminary recommendations for Utah Universal Public Telecommunications Service Support Fund ("UUSF") distributions for each of the URTA Members (collectively the "Recommendations").

2. Simultaneously, with the filing of the Recommendations, on October 4, 2018, the Division filed Comments alerting the Commission to several issues where there was disagreement between the URTA Members and the Division.

3. On October 5, 2018, the Commission issued a Notice of Scheduling Conference. The Scheduling Conference was held on October 11, 2018. On October 12, 2018, the Commission issued a Scheduling Order which required all interested parties to provide initial Comments on or before October 30, 2018, with reply Comments due November 15, 2018.

4. URTA, the DPU, the OCS, All West Communications, Inc., and Union Telephone Company filed Comments on October 30, 2018.

5. On November 15, 2018, All West Communications, Inc. withdrew its Comments. URTA, the DPU, and the OCS filed a Joint Request for an Additional Round of Comments. URTA, the DPU, and the OCS each also filed Reply Comments.

6. The issues as identified in the Comments and Reply Comments are as follows:

   a. Whether the Commission should apply an interest synchronization adjustment?

   b. What is the correct tax rate to apply to a telecom company's last annual report when grossing up the revenue requirement for normalization of taxes?

   c. What is the correct federally prescribed rate of return to apply? and

   d. What is the proper calculation and treatment of excess deferred income tax ("EDIT") as a result of the corporate tax rate change?

7. URTA, the DPU, and the OCS engaged in several meetings and settlement discussions to resolve any differences regarding issued raised by the Division's Recommendations. Based on the settlement discussions the Parties were able to reach agreement on all of the issues except for whether the Commission should apply an interest synchronization adjustment in calculating the companies' revenue requirements and UUSF disbursement.

8. Interest Synchronization.

a. The DPU believes that it is obligated under the Commission's Order dated March 31, 2016 in Docket 15-2302-01 (the "Carbon/Emery Order"), to apply an interest synchronization adjustment for the URTA members who have no debt in their capital structure.

b. As the Commission is also aware, URTA and its Members believe that an interest synchronization adjustment is no longer appropriate since the Carbon/Emery Order was issued prior to the Legislature's adoption of SB 130 which mandated the use of the Federal weighted average cost of capital rate of return for state purposes. The FCC and NECA do not apply interest synchronization in the calculation of high-cost loop support, and URTA Members believe that interest synchronization is not appropriate at the state level because it results in a lower rate of return than the federally prescribed rate for the companies with no debt.

c. The OCS takes no position on whether an interest synchronization adjustment is appropriate in light of SB 130.

<u>AGREEMENT</u>

WHEREFORE, based on their review of the Comments submitted and upon their extensive settlement discussions, the Parties hereby stipulate and agree as follows:

1. The DPU has reviewed the 2017 Annual Report of the URTA Members and made certain prudence adjustments to the annual reports of the URTA Members for the purpose of calculating UUSF disbursements.

2. The Parties agree to apply the 2017 corporate tax rate for the purpose of grossing up the revenue requirement for normalized taxes.

3. The Parties agree to apply the 2019 blended federally prescribed weighted average cost of capital rate of return which is 10.375% to calculate the UUSF disbursements for each of the URTA Members.

4. The Parties agree that using the 2017 corporate tax rates and the 2019 blended rate of return of 10.375%, as agreed to in paragraphs 2 and 3 above, results in UUSF Recommendations as follows:[2]

Table 1 (without interest synchronization adjustment)

Company	**2019 UUSF Recommendation**
All West Communications, Inc.	$1,618,765.00
Bear Lake Communications, Inc.	$0.00
Beehive Telephone Company	$1,836,663.00
Carbon/Emery Telcom, Inc.	$1,983,056.00
Central Utah Telephone, Inc.	$663,712.00
Direct Communications Cedar Valley, LLC	$1,853,611.00
Emery Telephone	$966,331.00
Hanksville Telcom, Inc.	$52,993.00
Gunnison Telephone Company	$196,717.00
Manti Telephone Company	$1,130,871.00
Skyline Telecom	$0.00
South Central Utah Telephone Association, Inc.	$5,378,573.00
UBTA-UBET Communications, Inc. dba Strata Networks	$3,324,890.00
Union Telephone Company	$0.00

[2] These calculations do no include an interest synchronization calculation as that issue is being reserved for Commission decision as discussed in Sections 5 and 6below.

5. The DPU will file its Work Papers supporting the numbers in Table 1 and Table 2 with the Commission on or before December 20, 2018.

6. The Parties believe that the interest synchronization matter has been fully briefed and submit this issue for decision by the Commission. In the event that the Commission determines that interest synchronization is not necessary or appropriate in light of SB 130, the Parties stipulate and agree that the UUSF Recommendations set forth above in **Table 1** should be approved by the Commission.

7. If the Commission determines that an interest synchronization adjustment was not eliminated by SB 130 and is an appropriate adjustment for the six (6) taxable companies with no debt[3] the Parties stipulate and agree that the UUSF Recommendations set forth in Table 2 should be approved by the Commission:

Table 2 (with interest synchronization adjustment).

Company	**2019 UUSF Recommendation**
All West Communications, Inc.	$1,618,765.00
Bear Lake Communications, Inc.	$0.00
Beehive Telephone Company	$1,836,663.00
Carbon/Emery Telcom, Inc.	$1,691,445.00
Central Utah Telephone, Inc.	$514,027.00
Direct Communications Cedar Valley, LLC	$1,853,611.00
Emery Telephone	$966,331.00
Hanksville Telcom, Inc.	$46,123.00
Gunnison Telephone Company	$174,554.00
Manti Telephone Company	$1,130,871.00
Skyline Telecom	$0.00
South Central Utah Telephone Association, Inc.	$5,378,573.00
UBTA-UBET Communications, Inc. dba Strata Networks	$3,324,890.00
Union Telephone Company	$0.00

8. The Parties agree that with regard to EDIT, the URTA Members will follow and comply with the National Exchange Carriers Association Reporting Guidelines as set forth in Section

[3] Bear Lake Communications, Inc.; Carbon/Emery Telcom, Inc.; Central Utah Telephone, Inc.; Gunnison Telephone Company; Hanksville Telcom, Inc.; and Skyline Telecom.

3.3 and 3.10, attached hereto as Exhibit 1. The EDIT account for each URTA Member, if any, will be a deferred regulatory liability account and the flow-back of EDIT amounts will be governed by use of either the Income Tax Credit Method or the Income Adjustment Method identified in Exhibit 1. Annual UUSF disbursements shall be offset by the annual amortized amount of EDIT. The Recommendations set forth in Tables 1 and 2 have been offset by EDIT as applicable. The parties stipulate and agree to work with each other and interested stakeholders, in good faith, on the flow-back of EDIT when off-set to UUSF distributions is not available.

9. The Parties stipulate and agree that the UUSF Recommendations based on the 2017 Annual Reports will not constitute precedent for the treatment of Alternative Connect America Cost Model ("A-CAM") funds received by A-CAM recipients going forward, and the Parties hereby request that the Commission open a separate docket to address A-CAM issues in 2019 and hold a Scheduling Conference to discuss the appropriate schedule.

10. To the extent this agreement may be inconsistent with Commission rules, the Parties hereto ask the Commission to waive any such Commission rules.

11. The Parties also stipulate and agree to work with each other and interested stakeholders in a good faith effort to reach agreement and propose modifications to rules as needed consistent with this Stipulation.

GENERAL PROVISIONS

1. The Parties stipulate to the admission of the Comments, Reply Comments, Recommendations and Confidential DPU Work Papers into evidence in this docket. This stipulation to the admission of the evidence does not represent an agreement by the Parties to any positions taken therein.

2. Not all Parties agree that each aspect of this Stipulation is warranted or

supportable in isolation. Utah Code Ann. § 54-7-1 authorizes the Commission to approve a settlement so long as the settlement is just and reasonable in result. While the Parties are not able to agree that each specific component of this Stipulation is just and reasonable in isolation, all of the Parties agree that this Stipulation as a whole is just and reasonable in result and in the public interest.

3. All negotiations related to this Stipulation are confidential, and no Party shall be bound by any position asserted in negotiations. Except as expressly provided in this Stipulation, neither the execution of this Stipulation nor the order adopting it shall be deemed to constitute an admission or acknowledgment by any Party of the validity or invalidity of any principle; nor shall they be construed to constitute the basis of an estoppel or waiver by any Party; nor shall they be introduced or used as evidence for any other purpose in a future proceeding by any Party except in a proceeding to enforce this Stipulation.

4. The Parties agree that no part of this Stipulation or the formulae and methods used in developing the same or a Commission order approving the same shall in any manner be argued or considered as precedential in any future case except with regard to issues expressly identified and resolved by this Stipulation. This Stipulation does not resolve any issues not specifically identified and settled herein. The Parties are free to take any position concerning such issues.

5. The Parties request that the Commission hold a hearing on this Stipulation. The Parties shall support the Commission's approval of this Stipulation. As applied to the DPU and the OCS, the explanation and support shall be consistent with their statutory authority and responsibility.

6. The Parties agree that if any person challenges the approval of this Stipulation or requests rehearing or reconsideration of any order of the Commission approving this Stipulation, each Party will use its best efforts to support the terms and

conditions of this Stipulation. As applied to the DPU and the OCS, the phrase "use its best efforts" means that they shall do so in a manner consistent with their statutory authority and responsibility. In the event that any person seeks judicial review of a Commission order approving this Stipulation, no Party shall take a position in that judicial review proceeding in opposition to the Stipulation.

7. Except with regard to the obligations of the Parties under the four (4) immediately preceding paragraphs of this Stipulation, this Stipulation shall not be final and binding on the Parties until it has been approved without material change or condition by the Commission.

8. This Stipulation is an integrated whole, and any Party may withdraw from it if it is not approved without material change or condition by the Commission or if the Commission's approval is rejected or materially conditioned by a reviewing court. If the Commission rejects any part of this Stipulation or imposes any material change or condition on approval of this Stipulation or if the Commission's approval of this Stipulation is rejected or materially conditioned by a reviewing court, the Parties agree to meet and discuss the applicable Commission or court order within five (5) business days of its issuance and to attempt in good faith to determine if they are willing to modify the Stipulation consistent with the order. No Party shall withdraw from the Stipulation prior to complying with the foregoing sentence. If any Party withdraws from the Stipulation, any Party retains the right to seek additional procedures before the Commission, including presentation of testimony and cross examination of witnesses, with respect to issues resolved by the Stipulation and no party shall be bound or prejudiced by the terms and conditions of the Stipulation.

9. This Stipulation may be executed by individual Parties or through two (2) or more separate, conformed copies, the aggregate of which will be considered as an integrated

instrument.

WHEREFORE, the Parties respectfully submit this Stipulation and Settlement Agreement for approval by the Commission and request that the Commission grant such approval.

[signature page to follow]

DATED this 14th day of December, 2018.

BLACKBURN & STOLL, LC

Kira M. Slawson
Attorneys for URTA and its Members

DIVISION OF PUBLIC UTILITIES

Chris Parker
Director Division of Public Utilities

OFFICE OF CONSUMER SERVICES

Michele Beck
Director Office of Consumer Services

DATED this 14th day of December, 2018.

BLACKBURN & STOLL, LC

Kira M. Slawson
Attorneys for URTA and its Members

DIVISION OF PUBLIC UTILITIES

Chris Parker
Director Division of Public Utilities

OFFICE OF CONSUMER SERVICES

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the JOINT STIPULATION AND SETTLEMENT AGREEMENT, Dockets 18-040-01, 18-042-01, 18-043-01, 18-046-01, 18-051-01, 18-052, 01, 18-053-01, 18-054-01, 18-576-01, 18-2180-01, 18-2201-01, 18-2302, 18-2303-01, 18-2419-01, et. al., was served the 14th of December, 2018 as follows:

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Exhibit 1

NECA REPORTING GUIDELINE 3.3 and 3.10

Guideline: 3.3 Excess Deferred Tax Development

Issue Date: 2/93 (Revised 08/18)

Description

Excess deferred income taxes were created as a result of the Tax Cuts and Jobs Act (TCJA) of 2017 (PL 115-97), wherein the corporate income tax was reduced from a maximum of 35% to a flat 21% rate. The Act had the effect of canceling certain future tax payments, i.e., the difference between taxes deferred at the higher previous rate and payable at the new 21% tax rate. This difference is referred to as Excess Deferred Income Tax. The excess deferred tax does not have to be paid to the Internal Revenue Service; effectively, it is a tax forgiveness. However, the excess must be flowed back to rate payers. This requirement applies to any company that will now pay taxes at a rate lower than the rate used to originally calculate the deferred tax. The requirement also relates only to regulated plant related deferred taxes.

This Guideline addresses the amortization of the excess deferred taxes and how these benefits are flowed back to rate payers.

Background

Public utilities are required, as a condition of using Modified Accelerated Cost Recovery System (MACRS) to use normalization accounting under which depreciation for ratemaking purposes doesn't reflect the accelerated depreciation under MACRS.

Section 1561(d) of the TCJA requires that public utilities using a normalization method of accounting return of excess deferred taxes to the ratepayer over the remaining life of the asset that gave rise to the excess. This treatment mirrors the treatment called for in the Tax Reform Act of 1986 (TRA)(PL 99-514, section 203(e)).

In connection with the TRA, the Federal Communications Commission (Commission) emphasized that the 203(e) method to flow back excess deferred taxes ratably over the life of the timing difference was mandatory for public utilities, not discretionary, and informed telcos that immediate flow back was not acceptable.[1] The Commission subsequently determined that this treatment was appropriate for all excess deferred taxes, both those that are subject to tax act requirements and those that result from all other timing differences.[2] As a result, ILECs must return excess deferred taxes to the ratepayer over the remaining life of the asset that gave rise to the excess.

Section 1561(d) of the TCJA requires that the excess be returned to the ratepayers using the average rate assumption method or another method subject to regulatory authority where books and underlying records do not contain the vintage account data necessary to apply the average rate assumption method. The excess deferred tax is returned (flowed-back) to the ratepayers at times and amounts similar to what would have been paid to the IRS, if the

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[1] Annual 1988 Access Tariff Filings, Memorandum Opinion and Order 3 FCC Rcd 1281 (1987) ¶ 107

[2] See Amendment of Part 32 Rules to implement SFAS No. 96 Accounting for Income Taxes, Report and Order, CC Docket No. 89-360, 9 FCC Rcd 727 (1994) ¶¶ 6-7.

corporate income tax rate had not changed. The return of the excess to the ratepayer is reflected in lower revenue requirements and hence, lower rates.

For NECA reporting purposes, the excess may be returned to ratepayers using one of two methods, the average rate assumption method or the average remaining life method.

Under the average rate assumption method, the excess deferred tax is reduced over the remaining lives of the regulated property which gave rise to the excess. Tax timing differences under this method are generally identified by group assets with similar lives. For each group of assets, companies must identify the “switching point”, i.e., the year where the tax timing difference turns from positive to negative. As of the switching point, the cumulative deferred taxes related to that asset or group of assets are accumulated and divided by the aggregate timing differences for the property. The resulting ratio (i.e., the “average rate”) is multiplied by the tax timing difference for each year following the switching point. The difference between this amount and the amount of deferred tax at the original tax rate is then flowed back each year.[3]

The average remaining life method may be used when the company's books and underlying records do not contain the vintage account or group asset data necessary to apply the average rate assumption method. In this case, the company divides the excess deferred tax by the remaining weighted average life of the assets that gave rise to the excess. This annual amount is then flowed back beginning in the first year of the tax rate change.

Under both methods, the total amount of excess deferred income tax is the same, however the amounts debited to Account 4340[4] and reported as excess deferred income tax annually is reported over a different period of years and will impact revenue requirements differently on an annual basis.

Companies should work with their accounting professionals to ensure they follow appropriate guidelines in calculating average remaining life for individual and/or group assets.

Analysis

Part 32 of the Commission's Rules includes excess deferred taxes in Account 4340, Net Non-current Deferred Operating Income Taxes.[5] Excess deferred tax amounts in Account 4340 is amortized and flowed-back to Account 7250, Provision for Deferred Operating Income Taxes - Net.[6] Account 7250 is credited with income tax differentials applicable to the current period resulting from prior deferrals.

Since Account 7250 is not treated in the separations process, (i.e., normalized taxes are calculated), a special adjustment for interstate settlements must be made to reflect the flow back of the interstate portion of excess deferred taxes. The excess deferred tax amount should be identified in the EC's accounting records, separated to interstate and allocated to the

[3] See, e.g., IRS Rev. Proc. 88-12, 1988-1 C.B. 637, Sec. 2.04 describing the average rate assumption method.

[4] 47 CFR § 32.4340

[5] Account 4340 may include deferred tax amounts not related to operations. Only the amounts in 4340 related to operations are required to be amortized and flowed back to ratepayers.

[6] 47 CFR § 32.7250

appropriate access elements as per FCC Parts 36 & 69 reported for interstate settlements in the calculation of federal income tax.

Excess deferred taxes may be separated in the cost study on the basis of the composite Account 4340 apportionment or based on the separation of Account 2001.[7] After the interstate amount of the excess deferred taxes are identified, these amounts should be allocated in Part 69 and resulting amounts reported in NECA pooling as an addition to Tax Credits or as an additional deduction included with Income Adjustments for FIT.

Attachment A illustrates the calculation of excess deferred taxes on a given asset base.

Attachment B page 1 illustrates the flow-back of excess deferred income taxes using the average rate assumption method and the resulting impact to Account 4340 annually and the amount reported as a reduction to FIT for pooling purposes.

Attachment B page 2 illustrates the flow-back of excess deferred income taxes using the average remaining life method and the resulting impact to Account 4340 annually and the amount reported as a reduction to FIT for pooling purposes.

Attachment C illustrates two methods of implementing the flow-back of excess deferred tax amounts and reporting them to the NECA Pools:

> One is the Income Tax Credit Method which treats deferred taxes as a credit to reduce the amount of reimbursable federal income taxes. This method is preferred by NECA since the excess deferred tax amounts only affects Federal Income Taxes. These excess deferred taxes should be included with ITC Amortization amounts and reported to the pool on the EC1050, Lines 13, 21, and 42.
>
> The second alternative, the Income Adjustment Method, treats the excess deferred taxes as an income adjustment and reduces the federal income subject to tax. Using this method will have a secondary effect on State Income Tax since these taxes are developed using federal taxable income. If an EC chooses to use this method it should gross up excess amounts by dividing the separated excess deferred tax amounts by .21 and including the results with the Income Adjustments for FIT amounts. These will be reported to the pool on the EC1050, Lines 12, 20, and 41.

Conclusion

NECA members must include amortized excess deferred tax amounts, as discussed above, in their NECA pooling as a reduction in Federal Income Tax. The Income Tax Credit Method as referenced in this document is preferred by NECA because Federal Income Taxes are only affected with no secondary effect on State Income Tax.

The Federal Communication Commission (FCC) has authorized NECA to interpret FCC Rules

[7] 47 CFR § 32.2001 Telecommunications Plant in Service

where necessary.[8] Pursuant to this authorization, NECA has published this Reporting Guideline Paper. Notwithstanding NECA's recommended interpretation, the FCC retains the full authority to review NECA's Reporting Guideline Papers. In the event of such review, the FCC's findings, if contrary to NECA's position, will take precedence.

[8] *Safeguards to Improve the Interstate Access Tariff and Revenue Distribution Processes*, CC Docket 93-6, Report and Order to Show Cause, 10 FCC Rcd. 6243 (1995)

Attachment A

Illustrative Example

	DEVELOPMENT OF DEFERRED TAXES - $100,000 ASSET					
(A)	**(B)**	**(C)**	**(D)**	**(E)**	**(F)**	**(G)**
Year	**Tax Depreciation (5 Year)**	**Book Depreciation (10 Year)**	**Difference (B) - (C)**	**Tax Rate**	**Deferred Taxes (D) x (E)**	**Accumulated Deferred Taxes**
1	$35,000	$10,000	$25,000	34%	$8,500	$8,500
2	$25,000	$10,000	$15,000	34%	$5,100	$13,600
3	$20,000	$10,000	$10,000	34%	$3,400	$17,000
4	$15,000	$10,000	$5,000	21%	$1,050	$18,050
5	$5,000	$10,000	($5,000)	21%	($1,050)	$17,000
6	$0	$10,000	($10,000)	21%	($2,100)	$14,900
7	$0	$10,000	($10,000)	21%	($2,100)	$12,800
8	$0	$10,000	($10,000)	21%	($2,100)	$10,700
9	$0	$10,000	($10,000)	21%	($2,100)	$8,600
10	$0	$10,000	($10,000)	21%	($2,100)	$6,500
	EXCESS DEFERRED INCOME TAXES =				**$6,500**	
Note: Year 5 is the "switching Point" where booked depreciation begins to exceed the accelerated						
	depreciation used for tax purposes.					

Attachment B - Page 1

Illustrative Example

		CALCULATION OF EXCESS DEFERRED TAXES						
	Average Rate Assumption Method							
	= Sum of Deferred Tax Expense up to Switching Point / Sum of Book to Tax Difference up to							
		Switching Point						
	= $18,050 / $55,000 = 32.82% (Col G, Year 4 / Col D, Rows 1-4)							
(A)	**(B)**	**(C)**	**(D)**	**(E)**	**(F)**	**(G)**	**(H)**	**(I)**
Year	**Tax Depreciation (5 Year)**	**Book Depreciation (10 Year)**	**Difference (B) - (C)**	**Tax Rate**	**Deferred Taxes (D) x (E)**	**Deferred Taxes Without Rate Change***	**Excess Deferred Taxes (F) - (G)**	**Accumulated Deferred Taxes**
1	$35,000	$10,000	$25,000	34.00%	$8,500	$8,500	$0	$8,500
2	$25,000	$10,000	$15,000	34.00%	$5,100	$5,100	$0	$13,600
3	$20,000	$10,000	$10,000	34.00%	$3,400	$3,400	$0	$17,000
4	$15,000	$10,000	$5,000	21.00%	$1,050	$1,050	$0	$18,050
5	$5,000	$10,000	($5,000)	32.82%	($1,641)	($1,050)	($591)	$16,409
6	$0	$10,000	($10,000)	32.82%	($3,282)	($2,100)	($1,182)	$13,127
7	$0	$10,000	($10,000)	32.82%	($3,282)	($2,100)	($1,182)	$9,845
8	$0	$10,000	($10,000)	32.82%	($3,282)	($2,100)	($1,182)	$6,564
9	$0	$10,000	($10,000)	32.82%	($3,282)	($2,100)	($1,182)	$3,282
10	$0	$10,000	($10,000)	32.82%	($3,282)	($2,100)	($1,182)	$0
Total							($6,500)	
	* From Attachment A							

Attachment B – Page 2

Illustrative Example

		CALCULATION OF EXCESS DEFERRED TAXES						
	Average Remaining Life Method							
	= Annual Flowback = Excess Deferred Tax / Weighted Average Remaining Life since tax rate change							
	= $6500 / 7 = $929 / Year							
(A)	**(B)**	**(C)**	**(D)**	**(E)**	**(F)**	**(G)**	**(H)**	**(I)**
Year	**Tax Depreciation (5 Year)**	**Book Depreciation (10 Year)**	**Difference (B) - (C)**	**Tax Rate**	**Deferred Taxes (D) x (E)**	**Excess Deferred Taxes**	**Total Deferred Taxes**	**Accumulated Deferred Taxes**
1	$35,000	$10,000	$25,000	34.00%	$8,500	$0	$8,500	$8,500
2	$25,000	$10,000	$15,000	34.00%	$5,100	$0	$5,100	$13,600
3	$20,000	$10,000	$10,000	34.00%	$3,400	$0	$3,400	$17,000
4	$15,000	$10,000	$5,000	21.00%	$1,050	($929)	$121	$17,121
5	$5,000	$10,000	($5,000)	21.00%	($1,050)	($929)	($1,979)	$15,143
6	$0	$10,000	($10,000)	21.00%	($2,100)	($929)	($3,029)	$12,114
7	$0	$10,000	($10,000)	21.00%	($2,100)	($929)	($3,029)	$9,086
8	$0	$10,000	($10,000)	21.00%	($2,100)	($929)	($3,029)	$6,057
9	$0	$10,000	($10,000)	21.00%	($2,100)	($929)	($3,029)	$3,029
10	$0	$10,000	($10,000)	21.00%	($2,100)	($929)	($3,029)	$0
Total						($6,500)		

ATTACHMENT C

Illustrative Example

		NECA Reporting of Excess Deferred Income Tax	
	Item	Exess Deferred Tax Treated as a Tax Credit EC1050 Lines 13, 21 & 42	Excess Deferred Tax Treated as an Income Adjustment EC1050 Lines 12, 20 & 41
1	Return (@ 10.50%)	$500,000	$500,000
2	Income Adjustment		$1,444
3	Tax Credit (Excess Deferred)	$303	
4	After Tax Income	$499,697	$498,556
5	Tax Gross-up Rate	0.265822785	0.265822785
6	Tax Before Credit	$132,831	$132,527
7	Tax After Credit	$132,527	$132,527
8	Expenses	$600,000	$600,000
9	Revenue Requirement	$1,232,527	$1,232,527
Notes:	Assume 28% of Excess Deferred Tax is separated to interstate in Part 36. 6500 x .28 = $1820.		
	(This amount must also be allocated to the Part 69 rate elements.)		
	Assume payback of $1820 excess deferred tax occurs over 6 years = $303/year		
	(6 years is remaining life under average rate method; if using average life method,		
	payback would occur over 7 years)		
	Gross-up excess deferred tax = 303/.21 = $1444 Income Adjustment		

Guideline: **3.10** **Income Tax Expense and Accumulated Deferred Income Tax**

Issue Date: **6/13**

Description

The purpose of this NECA Reporting Guideline is to provide guidance for calculating and reporting operating regulated Federal and State Income Tax expense for High Cost Loop (HCL), Local Switching Support (LSS) and NECA pool reporting.

The current year's federal and state income tax expense (provision) is calculated at the total company level by applying the applicable statutory income tax rate to unseparated operating income before tax. The operating regulated expenses are recorded in accounts 7220, 7230 and 7250. The calculation must be according to Part-32.22 (which specifies normalization), NECA Reporting Guideline 3.2 - Statement of Financial Accounting Standards (SFAS)-109, NECA Reporting Guideline 3.6 - Rural Telephone Cooperative Income Tax Expense and APB-11. Subchapter-S corporations and other pass-through entities should follow NECA Reporting Guideline 3.1- Sub Chapter S Corporations, Partnerships and Certain Limited Liability Companies for calculating amounts recorded in 7220, 7230 and 7250.

Federal and State income tax expense must be assigned to jurisdiction under Part-36.412 and apportioned to rate elements under Part-69.402.

Income adjustments used in the calculation of income tax are also discussed. See NECA Reporting Guideline 3.5 – Non Operating Fixed Charges and 2.3 - Separation of Interest and Related Items, Account 7500.

Federal Income Taxes (FIT)

1. For High Cost Loop (HCL), companies calculate and record operating regulated FIT attributable to the current period in accounts 7220 and 7250. Part 36.611 defines current period for annual submissions as the calendar year preceding each July 31st filing. Part 36.612 defines current period for one or more voluntary quarterly submissions as a rolling year. For example the first voluntary update covers the last nine months of the previous calendar year and the first three months of the existing calendar year and submitted no later than September 30th of the existing year. Therefore, in this example, reported amounts for FIT should be based on 12 months period ending September 30. Companies must ensure non-regulated and non-operating FIT amounts are excluded and report operating regulated FIT. Sub Chapter–S Corporations and other pass-through entities must also report FIT on a period ending basis and should follow NECA Reporting Guideline 3.1 for calculating FIT.[1]

[1] See NECA's December 23, 2009 letter to General and pool contacts at Subchapter S Corporations, LLCs, and Partnerships.

Guideline: 3.10 Income Tax Expense and Accumulated Deferred Income Tax

2. For Local Switching Support (LSS) Reporting, the Federal Income Tax is calculated by the Administrator in accordance with Part 54.301(d) (4). Also see Part 54.301(a)(1) for the implications of the USF/ICC Transformation Order.

3. For NECA Pool Reporting, companies are compensated for the interstate portion of Federal Income Taxes. Per Part 36.412 total regulatory income tax expense is assigned to jurisdiction based on its "approximate net taxable income (positive or negative)" less fixed charges. Part-69 contains the same language. The FIT allowance for pooling uses a gross-up calculation to satisfy Part 36 and 69. The gross-up of interstate Return on Investment (ROI) is based on the authorized interstate Rate of Return (ROR) and the total company effective tax rate. ROI is multiplied by the ratio of the total company Effective Tax Rate (ETR) to (1 minus the total company ETR). Companies may refer to Exhibit 5-1A in the Pool Administration Procedures – Cost Company for the calculation.

State Income Taxes (SIT)

1. For High Cost Loop (HCL), companies calculate and record operating regulated SIT attributable to the current period in accounts 7230 and 7250. Part 36.611 defines current period for annual submissions as the calendar year preceding each July 31st filing. Part 36.612 defines current period for one or more voluntary quarterly submissions as a rolling year. For example the first voluntary update covers the last nine months of the previous calendar year and the first three months of the existing calendar year and submitted no later than September 30th of the existing year. Therefore, in this example, reported amounts for SIT should be based on 12 months period ending September 30. Companies must ensure non-regulated and non-operating SIT amounts are excluded and report operating regulated SIT. Sub Chapter–S Corporations and other pass-through entities must also report SIT on a period ending basis and should follow NECA Reporting Guideline 3.1 for calculating SIT.

2. For Local Switching Support (LSS), companies should report operating regulated SIT in accordance with FCC Rule 54.301 (b). Also see Part 54.301(a)(1) for the implications of the USF/ICC Transformation Order.

3. For NECA Pool Reporting, companies may report the interstate portion of operating regulated State & Local Income Tax expense recorded in Account 7230 and the SIT portion of 7250 as part of the Expense & Other Tax reported to Carrier Common Lines and Traffic Sensitive Pools.

   Alternatively, for NECA Pool Reporting, companies (including pass-through entities) may report grossed-up interstate operating regulated State & Local Income Tax expense based upon reported interstate ROI, Income Adjustments, and ITC Amortization.

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Once a method is selected it must be used consistently on a going forward basis and cannot change for subsequent periods.

Income Adjustments

Income adjustments adjust ROI for items that are not included in pre-tax book income, however are included in the regulated FIT and SIT provision calculation. Income adjustments should not be confused with temporary differences. Temporary differences are included in both book income before tax and the tax return, however in different years. Temporary book and tax differences do not affect the tax gross-up since there is no difference over a span of years.

1. Income adjustments for non-operating and unregulated items are not used in ratemaking.

2. For Local Switching Support (LSS), companies report amount in account 7500 (interest expense) and 7210 (investment tax credit – net). Also see Part 54.301(a)(1) for the implications of the USF/ICC Transformation Order.

3. For NECA Pooling (Cost Studies), only the Interstate portion of Account 7500, Interest Expense and adjustment for certain permanent Federal Income Tax differences may be reported as Income Adjustments.

4. Separation of Fixed Charges in 7500 should follow NECA Reporting Guideline 2.3 and NECA Reporting Guideline 3.5. Interest related to Capital Leases should first be identified and separated on the basis of associated investment in Account 2680, Capital Leases (Part 36.223). The remaining Interest expense should be split between operating and non-operating interest expense following the Operating Fixed Charges Worksheet in NECA Reporting Guideline 3.5. The resulting Operating Fixed Charges are separated based upon net-investment (excluding 2680). There are some minor acceptable differences between various allocators related to the inclusion or exclusion of “gray area” items (e.g. Cash Working Capital, 1402) in net investment.

5. Before separated interest expense is reported on the EC 1050, it must first be adjusted per Exhibit 5-1A in the Pool Administration Procedures – Cost Company. This step is necessary to determine the appropriate amount of Federal Income Tax to include in the company’s settlement taking into account the individual company’s effective Federal Income Tax Rate. Exhibit 5-1B in the Procedures is provided to help estimate this effective FIT Rate.

6. In addition to Fixed Charges, NECA has allowed an adjustment for 50 percent of Meals and Entertainment as a permanent difference. This adjustment is determined by first separating this difference amount to the appropriate pool levels. Then it is divided by 0.65 (1 minus the FIT Rate). This result may be subtracted from separated, operating fixed charges and reported to the appropriate Income Adjustment lines on the EC 1050.

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Following is a list of items that have frequently been submitted as an income adjustment, but are not includable for adjusting ROI for tax gross-up:

1. Other Post Retirement Benefits (OPEB) – temporary difference.
2. Lobbying or Political Contributions- permanent difference and non-operating.
3. Yellow Pages-non-regulated
4. Net Salvage - temporary difference.
5. Interest Income on Municipal Bonds - permanent federal difference.
6. Contributions in Aid of Construction (CIAC) - temporary difference.
7. Net Operating Loss (NOL) - there is no interstate NOL.
8. Key Man Insurance and policies to fund ownership buy-outs. Key Man is a permanent difference and funding buy outs is non-operating.
9. Vacation Accruals – temporary difference.
10. Property Tax Accruals temporary difference.
11. Non-Deductible Travel – permanent or non-operating.

Accumulated Deferred Income Taxes (ADIT)

While accounts 4100 - Net Current Deferred Operating Income Taxes and 4340 – Net Noncurrent Deferred Operating Income Taxes are used to record operating Federal and State deferred taxes for both plant related and non-plant related items, FCC rules generally limit amounts in accounts 4100 and 4340 used for the interstate rate base calculation to those related to total plant in service.[2] Therefore, non-plant related amounts recorded in accounts 4100 and 4340 should not be included in the cost study for reimbursement from regulated operations. Part 32 requires maintaining separate TPIS category records by vintage (i.e., year in which the equipment was placed in service) when accelerated depreciation has been used.[3] These records ensure the ability to identify these TPIS related amounts within the total net account 4340 balance. Deferred tax liabilities are generated when tax depreciation is faster than book depreciation. A tax deduction that is larger than the book depreciation expense results in less current taxes due to the IRS than the tax expense used to calculate revenue requirements. These deferred taxes, along with others, are recorded for financial reporting purposes in accordance with SFAS-109,[4] which was adopted by the FCC in 1994.[5] In accordance with NECA's March 9, 2007 letter, amounts recorded in accounts 4100 or 4340 and balances reported for Part 65 must be in compliance with applicable FCC rules and regulations.

[2] FCC 70-715 Report and Order to adopt deferred tax accounting for accelerated depreciation; 47 C.F.R. §§ 65.820 and 65.830; 36.506(a); Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers, FCC 87-391 (1987), ¶ 47-48; Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers, FCC 89-30 (1989), ¶ 48-53

[3] See 47 C.F.R. § 32.22.

[4] Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*, Financial Accounting Standards Board, February 1992. SFAS-109 superceded APB-11. *See* SFAS-109, at Appendix D, ¶ 286(c).

[5] Amendment of Part 32 of the Commission's Rules to Implement Statement of Financial Accounting Standards No. 96, Accounting for Income Taxes, *Report and Order,* CC Docket No. 89-360, 9 FCC Rcd 727 (1994).

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Non-operating deferred taxes are properly classified to account 4350 - Net Noncurrent Deferred Non-operating Income Taxes. Examples of non-operating deferred taxes include the deferred taxes related to unrealized gains or losses on marketable securities or related to the amortization of goodwill. Companies should ensure that non-operating deferred taxes are reported in account 4350.

1. For High Cost Loop (HCL), companies report operating regulated, subject to separation Federal and State Deferred Income Tax. The amount reported should be limited to the portion of account 4340 related to plant in service Sub-Chapter S and other pass-through entities should also report deferred taxes.

2. For Local Switching Support (LSS Reporting), companies report operating regulated ADIT in accordance with FCC Rule 54.301. Sub-Chapter S and other pass-through entities should also report deferred taxes.

3. For NECA Pool Reporting, companies report the interstate portion of operating regulated Federal and State Deferred Income Tax as part of Average Net Investment for monthly pool reporting. The amount reported should be limited to the portion of account 4340 related to total plant in service. Sub-Chapter S and other pass-through entities should also report deferred taxes.

Conclusion

The Current year's federal and state income tax expense (provision) and plant related ADIT should be calculated and reported in compliance with Parts 32, 36, 54, 65 and 69. NECA will only accept cost reporting in compliance with these interpretations.

The Federal Communication Commission (FCC) has authorized NECA to interpret FCC Rules where necessary.[6] Pursuant to this authorization, NECA has published this Reporting Guideline Paper. Notwithstanding NECA's recommended interpretation, the FCC retains the full authority to review NECA's Reporting Guideline Papers. In the event of such review, the FCC's findings, if contrary to NECA's position, will take precedence.

[6] *Safeguards to Improve the Interstate Access Tariff and Revenue Distribution Processes*, CC Docket 93-6, Report and Order to Show Cause, 10 FCC Rcd. 6243 (1995)