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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

AVISTA CORPORATION'S APPLICATION FOR AN ACCOUNTING ORDER FOR APPROVAL TO CHANGE ITS ACCOUNTING FOR FEDERAL INCOME TAX EXPENSE FOR CERTAIN PLANT BASIS ADJUSTMENTS AND DEFERRAL OF ASSOCIATED CHANGE IN TAX EXPENSE	)	**CASE NO. AVU-E-20-12/ AVU-G-20-07** **COMMENTS OF THE COMMISSION STAFF**

The Staff of the Idaho Public Utilities Commission ("Staff") submits the following comments regarding the above referenced case.

BACKGROUND

On October 30, 2020, Avista Corporation ("Company") applied to: (1) change its accounting for federal income tax expense from a normalization method to a flow-through method for certain plant basis adjustments, and (2) defer associated change in tax expense. *Application* at 1.

The Company uses the normalization method to calculate federal income taxes for most plant-related temporary book-to-tax differences. *Id.* The Company now requests authorization to use the flow-through method to calculate certain plant basis adjustments, which it represents will immediately benefit customers. *Id.* The Company proposes to defer those benefits and to start providing them to customers in its next general rate case. *Id.*

STAFF ANALYSIS

Staff recommends that the Commission approve the Company's Application authorizing the Company to change its accounting method for federal income tax expense from a normalization method to a flow-through method for certain plant basis adjustments, including Industry Director Directive No. 5 ("IDD#5") and meters. For tax purposes, the changes in the accounting treatment will reclassify certain previous capital expenditures as expenses and will fall under the Internal Revenue Code ("IRC") 481(a) adjustments[1]. In Private Letter Ruling ("PLR") 202010002, the Internal Revenue Service provided guidance that Accumulated Deferred Federal Income Tax ("ADFIT") resulting from repair-related IRC § 481(a) adjustments is not subject to the normalization method of accounting. Furthermore, the utilization of the flow-through method on certain plant basis adjustments will provide immediate benefits to customers.

The tax normalization accounting method is used by regulated public utilities to reconcile the tax treatment of accelerated depreciation of assets with their regulatory treatment. The different treatment between tax accounting and regulatory accounting creates deferred income taxes. Under normalization, a utility receives the tax benefit of accelerated depreciation in the early years of an asset's regulatory useful life, and then passes that benefit through to ratepayers ratably over the regulatory useful life of the asset by using the associated ADFIT to offset rate base, thereby lowering customer rates.

The Flow-through tax accounting method treats the actual current federal income tax liability of the regulated utility as the utility's tax expense in the determination of the utility's rates. The accelerated depreciation is considered immediately deductible and reduces the utility's rates through the reduction of the utility's current income tax expense. Consequently, the accumulated deferred tax reserves that are flowed through are not included in the rate base calculation because the tax benefit was already provided to customers.

The IDD#5 projects and meters have been capitalized and under IRC §263(a) are considered protected assets and subject to the requirements of tax normalization accounting. These requirements typically do not allow the direct or indirect flow-through of accelerated depreciation tax benefits to ratepayers. However, under Treasury Regulation § 1.263A-1(f)(4), a utility is permitted to use any reasonable method to properly allocate direct and indirect costs

[1] When a taxpayer changes its accounting method, IRC § 481(a) adjustments are required to be made to prevent items from being duplicated or omitted.

among units of property produced or property acquired for resale during the taxable year. On this basis, the IRS allows the flow-through accounting method, which the Company proposes to use for IDD#5 mixed service costs and meters.

<u>IDD No. 5</u>

In 2009 and 2014, the IRS division of Large Business and International Division ("LB&I") issued an Industry Director Directive regarding the method of allocating mixed service costs of self-constructed assets under IRC § 263(a). The IDD provided guidance in determining whether a taxpayer's method for allocating mixed service costs of certain self-constructed assets, such as tangible personal property, is appropriate. Self-constructed assets are assets produced by the taxpayer for use by the taxpayer in its trade or business. IDD#5 relates to mixed services costs that are part of the capitalized book costs of utility property but can instead be capitalized to inventory and deducted immediately for federal income tax purposes.

Under the Treasury Regulation § 1.263A-1(e)(4)(ii)(C), mixed service costs are service costs that are partially allocable to production or resale activities (capitalizable) and partially allocable to nonproduction or non-resale activities (deductible). As an example, a factory worker's recruitment costs incurred by the personnel department are costs which are allocable to production activities and therefore capitalized while the costs incurred by the personnel department for the development of wage, salary, and benefit policies are allocable to nonproduction or non-resale activities and would be deductible.

<u>Meters</u>

The Company currently capitalizes and depreciates meters over 5 to 20 years for tax purposes and over 15 to 20 years for regulatory book purposes depending on the meter type. IRC § 162 allows a deduction for all ordinary and necessary expense paid or incurred during the taxable year in carrying on any trade or business. Under Treasury Regulation § 1.162-3(c), materials and supplies are defined as property that has an acquisition cost of $200 or less that is consumed in the taxpayer's operation and is not considered inventory. The Company proposes to deduct meter costs instead of capitalizing them if the per unit cost is less than $200.

Benefits to Ratepayers

Each of the accounting method changes described above were evaluated under the IRC § 481(a) which allows Avista to take deductions for prior periods (catch-up deductions). The excess deferred income tax ("EDIT") amounts associated with this tax depreciation is also reclassified to the basis adjustment moving it from protected to non-protected. The amount of ADFIT related to IDD#5 and meters that are available for flow-through to customers, as of December 31, 2019, is estimated to be approximately $134 million (system), or $38.4 million (Idaho), that can be recorded as a regulatory liability and returned to customers in future rate cases.

The changes in accounting methods were included in the Company's 2019 federal income tax return that was filed in October 2020 but will be reviewed by the IRS during a future audit of the Company's tax return. The Company will record the 2019 tax return adjustments and all future monthly tax accruals using the normalization method, until the Company receives approval to change to the flow-through method in all three of its jurisdictions. This will allow the Company to continue to record deferred taxes and will increase the ADFIT balance. When approval is received from all three states for the Company to switch to the flow-through method for meters and IDD#5 mixed services costs, the Company will record the amounts that have accumulated at that point to FERC Account No. 254.3 – Regulatory Liability. The Company will then be able to amortize the accumulated tax credits recorded in the regulatory liability account in a manner approved by the Commission.

CUSTOMER COMMENTS

The Commission set a comment deadline of December 31, 2020. As of December 30, 2020, no customer comments had been filed.

STAFF RECOMMENDATION

Staff recommends the Commission approve the Company's Application allowing the Company to change its tax accounting method for federal income tax expense from a normalization method to a flow-through method for certain plant basis adjustments, including IDD#5 mixed services costs and meters and to defer the benefits associated with the changes for future return to customers.

Respectfully submitted this 31st day of December 2020.

John R. Hammond, Jr.
Deputy Attorney General

Technical Staff: Johan Kalala-Kasanda
Donn English

i:umisc:comments/avue20.12_avug20.7jhjk comments

CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 31st DAY OF DECEMBER 2020, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NOS. AVU-E-20-12/AVU-G-20-07, BY E-MAILING A COPY THEREOF, TO THE FOLLOWING:

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