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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION	)	CASE NO. AVU-E-21-01
OF AVISTA CORPORATION FOR THE	)	CASE NO. AVU-G-21-01
AUTHORITY TO INCREASE ITS RATES	)	
AND CHARGES FOR ELECTRIC AND	)	DIRECT TESTIMONY
NATURAL GAS SERVICE TO ELECTRIC	)	OF
AND NATURAL GAS CUSTOMERS IN THE	)	RYAN L. KRASSELT
STATE OF IDAHO	)	
	)	

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

1 **I. INTRODUCTION**

2 **Q. Please state your name, employer and business address.**

3 A. My name is Ryan L. Krasselt and I am employed as the Vice President,
4 Controller and Principal Accounting Officer of Avista Corporation ("Avista" or "Company").
5 My business address is 1411 East Mission Avenue, Spokane, Washington.

6 **Q. Would you briefly describe your educational background and professional**
7 **experience?**

8 A. Yes. I received a Bachelor of Science degree with a double major in accounting
9 and finance from the University of Idaho in 1994, and I am a certified public accountant
10 (CPA). I joined Avista in 2001 as a financial business partner in the accounting department,
11 and gained further experience including leadership roles within treasury and risk management.
12 I was named to my current position in October 2015, where I am responsible for accounting,
13 taxes, financial reporting and internal controls for the Company. Prior to joining Avista, I was
14 a senior manager at the accounting firm PricewaterhouseCoopers, where I oversaw audit
15 engagements. In addition to this experience, I have completed the Utility Executive Course
16 at the University of Idaho.

17 **Q. What is the scope of your testimony in this proceeding?**

18 A. My testimony will address the Company's application[1] filed with the Idaho
19 Public Utilities Commission ("Commission") on October 30, 2020 (Case Nos. AVU-E-20-12
20 and AVU-G-20-07), requesting authorization to change the Company's accounting for federal
21 income tax expense from the normalization method to a flow-through method for certain plant

[1] The Company has requested in its Tax Accounting Application approval of the change in accounting, and the deferral of benefits, on or before May 1, 2021, to ensure approval from all three jurisdictions is received in time to apply this change and return the customer benefits in each state effective with each general rate case.

1 basis adjustments, including Industry Director Directive No. 5 (IDD #5) and meters, which
2 are described in more detail below.[2] Approval of the Company's application would provide
3 immediate benefits to customers, which the Company is requesting approval to defer[3], and to
4 begin amortization through separate tariff of those benefits, concurrent with the effective date
5 of this GRC. As explained later in my testimony, approval in all three of Avista's jurisdictions
6 (Idaho, Washington and Oregon) to make this change is required, and any changes need be
7 adjusted concurrent with a GRC, as it has significant impact on rate base.

8 As discussed by Company witness Ms. Andrews, the proposed amortization by the
9 Company of the electric tax benefits ($31.3 million), beginning September 1, 2021 through
10 separate "Tax Customer Credit" Tariff Schedule 76 (electric) of $24.783 million, offsets the
11 Company's base electric rate relief requested in its entirety for Rate Year 1 (September 1,
12 2021) until approximately November 30, 2022. The result is no billed impact to electric
13 customers for the Rate Year 1 increase. Customers would, however, see a bill increase for
14 Rate Year 2, effective September 1, 2022 of 3.2% or $8.722 million.

15 For natural gas customers, as discussed by Ms. Andrews, the Company proposes to
16 begin amortizing the natural gas tax benefits ($12.1 million) beginning September 1, 2021
17 over a 10-year period, through separate "Tax Customer Credit" Tariff Schedule 176 of
18 approximately $1.226 million annually. This would offset the slight increase in Rate Year 1

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[2] During 2020, Avista worked with consultants on a tax review project. The outcome of this project was to expand on the tax deduction for repairs expenses that the Company originally implemented in 2014 and to modify its tax method for accounting for certain costs relating to meters and mixed service costs. This change allowed the Company to deduct costs for tax purposes that previously were capitalized, thereby reducing current federal income taxes owed to the IRS. This change was included with the 2019 federal tax return that was filed in October 2020. While the Company expanded its deduction for repairs expenses, the deferred taxes for this deduction will continue to be normalized and therefore, are not part of the deferral application or the credits available for the Tax Customer Credits.

[3] On December 31, 2020 in Case Nos. AVU-E-20-12 and AVU-G-20-07 Commission Staff filed comments supporting the Company's application as filed.

1 ($52,000) and result in an overall reduction for natural gas customers of approximately 1.8%
2 at that time on a billed basis.[4]

3 I will specifically address the Internal Revenue Service ("IRS") normalization
4 requirements versus flow-through requirements related to these plant basis adjustments, also
5 referred to as non-protected assets. Avista is currently calculating federal income taxes
6 utilizing the normalization method for the majority of plant-related temporary book-to-tax
7 differences. I will describe the proposal by Avista to utilize the flow-through method on
8 certain plant basis adjustments, which will provide immediate benefits to customers.

9 A table of contents for my testimony is as follows:

10 **Table of Contents**

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16

17 **Q. Are you sponsoring any exhibits to be introduced in this proceeding?**

18 A. Yes. I am sponsoring Exhibit No. 4, Schedule 1 through Schedule 3. Schedule
19 1 shows the estimated amount of accumulated deferred federal income taxes (ADFIT) at
20 December 31, 2020 that will be available to customers if the Company receives approval from
21 all three Commissions to change to the flow-through method of accounting for those certain
22 plant basis adjustments. Schedule 2 provides the two IRS Private Letter Rulings ("PLR") that

[4] As discussed by Ms. Andrews, customers would see a slight bill impact effective in Rate Year 2, effective September 1, 2022 of less than 0.1%, resulting from the proposed natural gas base rate increase of $950,000, offset by separate Tariff 177, titled "Natural Gas Deferred Depreciation Expense," amortizing approximately $900,000 over the one-year period September 1, 2022 through August 31, 2023.

Avista is providing as support for its proposed accounting for federal income taxes. Schedule 3 provides two forms that were provided by Deloitte that Avista included in its 2019 Federal Income Tax Return that was filed in October 2020 (Form 3115, Application for Change of Accounting Method). These forms describe the new basis adjustments (IDD#5 and meters) that were included with the Company's deferral application.

II. CALCULATION OF FEDERAL INCOME TAXES

Q. Please describe how federal income taxes are computed by Avista in this general rate case.

A. Federal income taxes are computed by Avista in general rate cases as follows:

- First, current federal income tax is calculated. The starting point is "income before tax adjustments" (or pre-tax operating income). Deductible interest expense computed using rate case concepts (interest synchronization) is subtracted from pre-tax operating income to arrive at "net operating income before taxes". Federal income tax temporary and permanent adjustments, known as "book-to-tax" or "M-1" adjustments, are added or subtracted from net operating income before taxes to produce what is commonly known as the federal tax base. The federal tax base is reduced by the current state income tax deduction to arrive at federal taxable income. Federal taxable income is multiplied by the statutory corporate federal tax rate of 21% to arrive at the current federal income tax liability.

- Second, the provision for deferred income taxes is computed by multiplying the normalized temporary book-to-tax differences from the current income tax calculation by the applicable statutory income tax rate. The resulting deferred income tax expense is also the net annual change to the accumulated deferred federal income taxes component of rate base.

- Third, the amortization of the excess deferred federal income tax (EDIT) that arose in the Tax Cuts and Jobs Act of 2017 is computed using the average rate assumption method (ARAM) and is recorded as a reduction to federal income tax expense.

1 **Q. When computing the provision for deferred income taxes, what are the**
2 **methods that regulated utilities like Avista may use?**
3 A. There are two methods that regulated utilities may use to record the federal
4 income taxes related to book-to-tax differences, (1) normalization and (2) flow-through.
5 **Q. What is the normalization method?**
6 A. Using a normalization method to compute income tax expense simply means
7 that all of the income tax costs related to items in the current period will be computed, whether
8 paid in the current year or paid later. This method creates deferred income tax and the
9 associated accumulated deferred income tax that is subtracted from rate base.
10 Avista is required to treat certain plant-related items in a manner consistent with the
11 Internal Revenue Code normalization requirements and consistency rule in order to avoid a
12 normalization violation. Specifically, the plant related items should be passed through to
13 customers no more quickly than over the remaining book life of the underlying assets.
14 Additionally, all of the following items must be treated consistently: depreciation expense,
15 tax expense (including deferred tax expense), accumulated deferred taxes on the balance
16 sheet, and rate base.
17 **Q. What is the flow-through method?**
18 A. Flow-through accounting generally treats the actual current Federal income tax
19 liability of the regulated utility as the utility's tax expense in determining utility rates. Thus,
20 under flow-through accounting, the tax benefits of accelerated tax expense and other similar
21 items are taken into account immediately in determining utility rates (through their effect of
22 reducing current income tax expense). Accumulated deferred tax reserves related to tax items

1 that have been flowed through are not included in the rate base calculation as the tax benefit
2 was provided to customers.

3 **Q. What are deferred taxes?**

4 A. In general, deferred taxes are created when the time period of the tax deduction
5 for an expenditure differs from the time period of the book deduction for the same
6 expenditure. There are many differences between the accounting rules that FERC and the
7 Commission follow (referred to as the "book treatment") when compared to the rules that the
8 IRS requires taxpayers to follow (referred to as the "tax treatment"). An example is the
9 different depreciable lives used to depreciate utility property, plant, and equipment. Generally,
10 the tax life of an asset will be much shorter than the book life. If the tax deduction occurs
11 first, a deferred tax liability ("DTL") is created. If the book deduction occurs first, a deferred
12 tax asset ("DTA") is created.

13 **Q. What effect do deferred taxes have on customers?**

14 A. Deferred taxes impact customers in two ways. <u>First</u>, the tax expense that is
15 reflected in cost of service is comprised of two components – (a) current tax expense and (b)
16 deferred tax expense. When a timing difference originates, there is a shift between current tax
17 and deferred tax. The net tax effect of a timing difference is zero – it did not raise or lower
18 Avista's tax expense nor did it increase or reduce customers' cost of service. <u>Second</u>, in
19 between the origination of a timing difference and its reversal, there is a balance recorded in
20 a deferred tax account on Avista's balance sheet. The DTA or DTL is used in the rate setting
21 calculation to either increase or reduce the rate base upon which Avista's allowed rate of
22 return is applied, thus either increasing or lowering the revenue requirement.

23 **Q. Are there restrictions on the way plant-related items are reversed?**

1 A. Yes. The IRS imposes restrictions on the timing and amount of the reversal
2 under the normalization provisions.

3 **Q. Please describe the accounting for book-to-tax differences using the**
4 **normalization method and the flow-through method.**

5 A. A normalized book-to-tax difference is a temporary difference that for
6 accounting purposes adjusts current income tax expense and has an equal offset in deferred
7 income tax expense, thus the net effect to total book income tax expense is zero. On the other
8 hand, a flow-through book-to-tax difference is also a temporary difference that adjusts current
9 income tax expense, but does not have an offsetting deferred income tax expense amount. This
10 is illustrated in the following example using depreciation expense as the timing difference in
11 Tables 1 through 3.

12 **<u>Table 1: Example – Depreciation Book-to-Tax Difference</u>**

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Example Depreciation Information

Asset Cost = $400
Book Life = 4 years
Tax Life = 2 Years

	Book Depreciation Expense	Tax Depreciation Expense	Book-to-Tax Difference
Year 1	$ 100	$ 200	$ 100
Year 2	100	200	100
Year 3	100	-	(100)
Year 4	100	-	(100)
Total	$ 400	$ 400	$ -

21 Table 1 above shows that for tax purposes, the Company will deduct $100 more for
22 tax purposes than for book in the first two years and then that will reverse over the next two
23 years. Therefore, at the end of the four years, the Company will have recorded a book and tax

deduction for the entire $400 investment. This provides a cash benefit to the Company from the IRS.

Table 2: Example - Normalization Method

Federal Income Tax Expense using Normalization			
	Current Tax Expense (Benefit)	Deferred Tax Expense (Benefit)	Total Tax Expense (Benefit)
Year 1	$ (42)	$ 21	$ (21)
Year 2	(42)	21	(21)
Year 3	-	(21)	(21)
Year 4	-	(21)	(21)
Total	$ (84)	$ -	$ (84)

Using the normalization method of accounting for book-to-tax differences, the Company would record a consistent $21 tax benefit in each of the four years. This is done by recording deferred taxes on the book-to-tax differences. Customers do not realize the benefit of the timing difference (lower tax expense) in the first two years using this method. However, customers do benefit from a lower rate base as Accumulated DFIT is an offset to rate base lowering net plant.

Table 3: Example – Flow-Through Method

Federal Income Tax Expense using Flow-Through			
	Current Tax Expense (Benefit)	Deferred Tax Expense (Benefit)	Total Tax Expense (Benefit)
Year 1	$ (42)	$ -	$ (42)
Year 2	(42)	-	(42)
Year 3	-	-	-
Year 4	-	-	-
Total	$ (84)	$ -	$ (84)

Using the flow-through method of accounting for the book-to-tax differences, the Company would record the tax benefit in the first two years. This is done by recording no deferred taxes on the book-to-tax differences within the income statement. Using this method, customers realize the tax expense benefit of the timing differences allowed by the IRS in the first two years. However, customers do not benefit from a lower rate base as there is no Accumulated DFIT to offset or lower net plant.

III. IRS PROTECTED VS NON-PROTECTED

Q. What are the IRS requirements for protected assets?

A. The IRS requires normalization on book-to-tax differences it considers protected. The capitalizing of utility property under IRC§ 263(a) constitutes protected assets that are subject to the normalization requirement under IRC § 168(i)(9). The two primary areas that give rise to protected differences are book-to-tax differences for depreciation method and depreciable life of the asset (commonly referred to as "method/life differences"). The normalization requirements of the Internal Revenue Code are designed to prohibit the direct or indirect flow-through of accelerated depreciation tax benefits to utility customers. Other book-to-tax differences not related to method/life differences are considered non-protected, such as expenditures capitalized for book purposes but allowed as a deduction for tax purposes. These non-protected book-to-tax differences are not required to be normalized.

Q. Avista records the accumulation of deferred taxes related to plant in which FERC account?

A. Avista records the accumulation of deferred taxes on plant book-to-tax differences in FERC Account No. 282900. As of December 31, 2019, FERC Account No.

1 282900 contained a balance of $819 million that has been normalized prior to adjustments
2 related to the 2019 tax review completed by the Company as discussed below. After
3 adjustment for the 2019 tax review, the estimated balance is $885 million. Much of this
4 balance is protected because it relates to accelerated depreciation including bonus
5 depreciation[5].

6 **Q. Does FERC Account No. 282900 contain non-protected book-to tax**
7 **differences?**

8 A. Yes. Included in FERC Account No. 282900 is the accumulated deferred
9 federal income taxes related to non-protected basis adjustments (i.e. IDD #5, meters, repairs
10 and other).

11 **Q. How has Avista treated non-protected amounts in FERC Account No.**
12 **282900?**

13 A. Avista has historically normalized the entire FERC Account No. 282900
14 balance.

15 **Q. What is Avista proposing to change for certain non-protected amounts?**

16 A. Avista is proposing a change to the flow-through method for certain non-
17 protected basis adjustments discussed below. A breakdown of the protected and non-
18 protected deferred tax balances, after adjustment for the 2019 tax review, as of December 31,
19 2019 is shown in Table 4.

[5] Bonus depreciation is a tax incentive that allows a business to immediately deduct a large percentage of the purchase price of eligible assets, such as machinery, rather than write them off over the "useful life" of that asset.

Table 4: FERC Account No. 282900 ADFIT Detail

FERC Account No. 282900 - ADFIT Estimated Balance at December 31, 2019	
Protected	$ 599,773,098
Non-Protected - Proposed Flow-Through	106,824,795
Non-Protected - Other	178,574,508
	$ 885,172,401

Q. Are there restrictions from the IRS on changing non-protected assets to a flow-through method?

A. There is no restriction from the IRS on changing to flow-through for non-protected assets. In a recent Private Letter Ruling, (PLR 202010002), which has been provided in Exhibit No. 4, Schedule 2, the IRS held that the ADFIT resulting from the repair related IRC Section 481(a) adjustment is not subject to the normalization method of accounting within the meaning of the IRC Section 168(i)(9). They also held that the ADFIT resulting from expenditures (1) related to an item of property includible in rate base and recoverable as regulatory depreciation expense in the determination of the revenue requirement and (2) deducted as repairs under IRC Section 162 to public utility property within the meaning of IRC Section 168(i)(10) pursuant to the tax method of accounting change for repairs, is not subject to the normalization method of accounting.

In PLR 202033002, included in Exhibit No. 4, Schedule 2, the IRS ruled that depreciation-related ADFIT balances attributable to costs that were capitalized into depreciable tax basis of public utility property prior to a change in tax method of accounting, reclassifying such costs as current deductions, do not remain subject to the Section 168(i)(9)

1 deferred tax normalization rules, after the changes in tax method of accounting (and, thus,
2 presumptively are not required to be reversed using ARAM).

3 **Q. Is Avista required to obtain a Private Letter Ruling to determine if these**
4 **items are non-protected?**

5 A. No, it is not. Private Letter rulings obtained by other companies are used as
6 guidance in determining how the IRS may rule when facts and circumstances are similar.
7 Avista's facts and circumstances related to the non-protected basis adjustments described
8 below are similar to the facts and circumstances included in recent private letter rulings
9 attached as Exhibit No. 4, Schedule 2, and therefore will not require one specific for Avista.

10 **Q. What is Avista's reason to change to flow-through?**

11 A. By changing to the flow-through method of accounting for certain basis
12 adjustments, including IDD #5 and meters, Avista will have an estimated $106 million
13 (system) of ADFIT as of December 31, 2019, which represents approximately $134 million
14 (system) that can be recorded in a regulatory liability and used to offset customers' rates in
15 future general rate cases. Detail of these balances have been provided in Exhibit No. 4,
16 Schedule 1. A summary of the estimated ADFIT amount by jurisdiction is shown in Table 5
17 below.

Table 5: Tax Benefit by Jurisdiction at December 31, 2019

Tax Impact of Basis Adjustments (IDD #5 and Meters) December 31, 2019		
	ADFIT	**Grossed-up for Federal Taxes**
WA Electric	$ (40,748,313)	$ (51,580,143)
ID Electric	(21,941,399)	(27,773,923)
WA Natural Gas	(19,653,292)	(24,877,585)
ID Natural Gas	(8,422,839)	(10,661,822)
OR Natural Gas	(15,443,480)	(19,548,709)
	$ (106,209,323)	$ (134,442,181)

Avista would have an annual additional tax benefit each year, beginning in 2020, which would be available for immediate use to offset customers' rates estimated to be $16.4 million, shown in Table 6 below.

Table 6: Tax Benefit by Jurisdiction for Calendar 2020

Estimated Tax Impact of Basis Adjustments (IDD #5 and Meters) Annual Additional Amounts		
	ADFIT	**Grossed-up for Federal Taxes**
WA Electric	$ (5,179,775)	$ (6,556,678)
ID Electric	(2,789,110)	(3,530,519)
WA Natural Gas	(2,624,993)	(3,322,776)
ID Natural Gas	(1,124,997)	(1,424,047)
OR Natural Gas	(1,240,032)	(1,569,661)
	$ (12,958,907)	$ (16,403,679)

ADFIT is a reduction to rate base. If Avista was authorized to change to the flow-through method of accounting for certain basis adjustments, including IDD #5 and meters, and the tax benefits were to be given to customers over a shorter period than if using the normalization method, the ADFIT balance related to these basis adjustments would not be

included in the rate base calculation as the amount would have already been flowed through to customers.

As described in the application, after the Company receives approval from all three states to utilize the flow-through method of accounting for the basis adjustments described above, the Company will record the amounts that have accumulated at that point related to those basis adjustments to FERC Account No. 254.3 – Regulatory Liability at the grossed-up amount. Associated deferred taxes will be recorded on this deferral in FERC Account No. 190 – ADFIT. The net of these two accounts will equal the amount that had been recorded in FERC Account. No. 282900 and will be included as an offset to rate base until flow-through begins. This will allow customers to continue to receive the benefits of the basis adjustments, as a reduction to rate base, until such time the flow-through benefits are included in rates. Ms. Andrews provides the impact of the change to using the flow-through method of accounting for these basis adjustments and the impact of the deferral of those costs.

Q. Are you aware of any other utilities that utilize the flow-through method to account for federal income taxes on its non-protected book-to-tax differences?

A. Yes. First, in the Northwest we are aware that Idaho Power and Northwest Natural utilize the flow-through method of accounting for some of their non-protected book-to-tax differences. It is our understanding that the following state utility commissions have authorized flow-through accounting for certain of its regulated utilities: California, Idaho, Iowa, Louisiana, Montana, South Dakota, Maine, Wisconsin, Pennsylvania and New Jersey, although this is not an exhaustive list. Specific utility examples include, Pacific Gas and Electric Company in California, Pennsylvania Power and Light Electric Utilities Corporation,

1 NorthWestern Energy in Montana, South Dakota and Nebraska, Cleco Power LLC in
2 Louisiana, and Wisconsin Electric Power Company, to name a few.
3
4 **IV. 2019 TAX REVIEW**

5 **Q. What is the Company's 2019 tax review project?**

6 A. During 2020, Avista worked with consultants from the Deloitte accounting
7 firm on a tax review project. The outcome of this project was to modify its tax method for
8 accounting for certain costs relating to meters and mixed service costs. This change allowed
9 the Company to deduct costs for tax purposes that previously were capitalized, thereby
10 reducing current federal income taxes owed to the IRS. This change was included with the
11 2019 tax return that was filed in October 2020.

12 **Q. Why did the Company choose to do the tax review at this time and not**
13 **earlier?**

14 A. With the enactment of the Tax Cuts and Jobs Act (TCJA) passed in December
15 2017, the Company was no longer able to utilize bonus depreciation under IRC Section
16 168(k). The Company entered into the 2019 tax review project as a replacement for tax cash
17 savings.

18 **Q. What tax deductions were included in the Company's 2019 tax review**
19 **project?**

20 A. Avista is making changes to how it accounts for tax repairs, IDD #5, and
21 meters. These changes will be recharacterizing certain previous capital expenditures to
22 expense for tax purposes. The calculations are extremely complex, but the changes do not
23 affect how they are accounted for on the books. These changes will all fall under IRC §481(a)

1 adjustments and are included on the 2019 federal income tax return. Exhibit No. 4, Schedule
2 3 provides two forms that were provided by Deloitte that Avista included in its 2019 Federal
3 Income Tax Return that was filed in October 2020 (Form 3115, Application for Change of
4 Accounting Method). These forms describe the new basis adjustments (IDD#5 and meters)
5 that were included with the Company's deferral application

6 **Q. What is IDD #5?**

7 A. IDD #5 relates to mixed services costs that are part of the capitalized book
8 costs of utility property but can be capitalized to inventory. Mixed service costs are defined
9 as service costs that are partially allocable to production or resale activities (capitalizable) and
10 partially allocable to nonproduction or non-resale activities (deductible). Avista does not
11 deviate from its financial statement treatment of mixed service costs for federal income tax
12 purposes. An opportunity exists for Avista to change to an "other reasonable method" for
13 allocating mixed service costs. This results in less indirect costs being capitalized to self-
14 constructed assets for federal income tax purposes. The costs not capitalized to self-
15 constructed assets are deducted currently. Inventory allocation and engineering costs are the
16 main drivers.

17 **Q. What is the change to meters?**

18 A. Avista currently capitalizes and depreciates meters over 5 to 20 years for tax
19 purposes and over 15 to 20 years for book purposes depending on the meter type. I.R.C.
20 Section 162 allows a deduction for all ordinary and necessary expense paid or incurred during
21 the taxable year in carrying on any trade or business. Treas. Reg Section 1.162-3(c) materials
22 and supplies means tangible property that is used or consumed in the taxpayer's operations
23 that is not inventory and that –

1 (iv) Is a unit of property as determined under Section1.263(a)-3(e) that
2 has an acquisition cost or production cost… of $200 or less.
3
4 The meter accounting method change allows Avista, for income tax purposes, to
5 deduct meter costs instead of capitalizing them if the per unit cost is less than $200.

6 **Q. How are these changes being made for tax purposes?**

7 A. Each of the accounting method changes described above were evaluated under
8 IRC § 481(a) which allowed Avista to take deductions for prior periods (catch-up
9 deductions). The excess deferred income tax (EDIT) amounts associated with this tax
10 depreciation is also reclassed to the basis adjustment moving it from protected to non-
11 protected. Exhibit No. 4, Schedule 1 details the amounts related to IDD #5 and meters that
12 are available for flow-through to customers.

13 The change in accounting methods discussed above were included in the Company's
14 2019 federal income tax return that was filed in October 2020 but will be reviewed by the IRS
15 during a future audit of the Company's tax returns. The Company does not expect the
16 calculations to materially change due to future review by the IRS, however, if any adjustments
17 are made by the IRS, those amounts would result in adjustments to the amounts available to
18 be flowed through to customers through the proposed deferral.

19 **Q. Please summarize the Company's change to its 2019 Federal Income Tax**
20 **return and its method of accounting for these changes.**

21 A. With the assistance of two consultants (Deloitte and Ernst and Young), Avista
22 determined it could expand on the tax deduction for repairs expenses that the Company
23 implemented in 2014 and could modify its tax method for accounting for certain costs relating
24 to meters and IDD#5. Avista determined that all of these basis adjustments would be

considered non-protected by the IRS. Other Companies have obtained PLR's from the IRS related to similar basis adjustments that support that determination. Avista has provided those PLR's as support for this determination and therefore, does not believe it needs to request a PLR from the IRS.

As the deferred taxes associated with basis adjustments are non-protected, using the normalization method or the flow-through method to account for these taxes are both acceptable. Since the repairs basis adjustments, which began in 2014, had been normalized, Avista determined it was in the best interest of the customer and Company to continue to normalize those tax credits (refer to the testimony of Company witness Mr. Thies regarding balancing the impact to the customer and the Company). Since the meters and IDD#5 basis adjustments were new, Avista determined that the flow-through method would be appropriate, which allows the tax benefits to be given to customers over a shorter period than if using the normalization method. As discussed by Ms. Andrews, the Company is proposing that the new annual on-going deferred tax benefit available after December 31, 2020 would be returned to customers over a 10-year amortization period going forward. The 10-year amortization is significantly shorter, benefiting customers earlier than if the IDD#5 and meters basis adjustments remained using normalization accounting, which would amortize these balances over approximately 34+ years for IDD#5 and 15 years for meters.

V. CONCLUSION

Q. Would you please summarize your testimony in this proceeding?

A. Yes. As described in its Tax Accounting Application filed with the Commission on October 30, 2020, the Company is proposing to change to the flow-through

1 method of accounting for income taxes for the new non-protected plant basis adjustments
2 (IDD#5 and meters) that the Company developed with the 2019 tax review project it
3 completed in 2020. The Company has requested to defer the tax benefits by changing to the
4 flow-through method to be used in this GRC. Finally, the Company has requested approval
5 of the change in accounting, and the deferral of benefits, on or before May 1, 2021, to ensure
6 approval from all three jurisdictions is received in time to apply this change and return the
7 customer benefits in each state effective with each State's next general rate case.
8 As discussed by Ms. Andrews, the Company proposes to return to customers the tax
9 benefit, beginning September 1, 2021, for approximately one and one quarter (1¼) years for
10 electric and ten (10) years for natural gas, through separate Tariff Schedules 76 (electric) and
11 176 (natural gas), titled "Tax Customer Credit," of $24.783 million for electric and $1.226
12 million for natural gas, offsetting the Company's requested electric base rate relief, resulting
13 in no billed impact to electric customers; and reducing current natural gas billed rates by
14 approximately 1.8%.[6] Company witness Mr. Miller sponsors the new Tariff Schedules 76 and
15 176.[7]

[6] As discussed by Mr. Thies, because the return of the Tax Customer Credit benefits will have an impact on the Company's cash flow, weakening credit metrics tracked by the rating agencies, the Company requests that, regardless of the electric and natural gas base revenue <u>increases</u> approved in this case, the electric and natural gas tax benefit amortization does not go beyond base rate <u>increases</u> approved on an annual basis, and does not go beyond a two year amortization period for those <u>increases</u>. Currently the Company's credit rating is at BBB, two notches above "non-investment grade" rating levels. A downgrade to our ratings to one-notch above or to non-investment grade, could be possible if the Commission were to include a higher amortization balance than the approved rate increases. That is true as well if the Commission went beyond a two-year amortization period proposed in this filing. Any remaining balance after the two-year amortization of the rate period <u>increases</u> included in Tariff Schedule 76, for example, plus the on-going, incremental, annual deferred tax benefit recorded starting in January 2021 for both electric and natural gas, would be amortized over a 10-year period going forward in a future period. With regards to natural gas, with Rate Year 1 resulting in a de minimis rate change of $54,000, the Company has proposed the Customer Tax Credit through Tariff 176 be amortized over a 10-year period effective September 1, 2021.

[7] As discussed by Mr. Miller the amortization and the Tax Customer Credit Tariff Schedules 76 and 176, if approved as filed, would be in place from September 1, 2021 through November 30, 2022 for electric and August 31, 2031 for natural gas.

1 **Q. Does that conclude your pre-filed direct testimony?**

2 A. Yes, it does.