PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Communications Division **RESOLUTION T- 17617**
Carrier Oversight and Programs Branch **August 9, 2018**

R E S O L U T I O N

Resolution T-17617, Cal-Ore Telephone Company. Order Authorizing a Reduction of $156,806 in Adopted Revenue Requirement for Test Year 2018 and a Corresponding Reduction of $156,806 in California High Cost Fund-A Support for Test Year 2018 to flow through changes resulting from the Tax Cuts and Jobs Act of 2017.

SUMMARY

This resolution flows through revenue requirement and California High Cost Fund-A changes from the Tax Cuts and Jobs Act of 2017, which became effective on January 1, 2018. Specifically, this resolution adopts a revised revenue requirement of $2,987,818 for Cal-Ore Telephone Company's Test Year 2018, and a corresponding revised California High Cost Fund-A support amount of $1,312,905, resulting in a reduction of $156,806 in California High Cost Fund-A support for 2018.

BACKGROUND

The California High Cost Fund-A (CHCF-A) program operates in accordance with Public Utilities (P.U.) Code § 275.6. This statute requires the Commission to implement a program to reduce any rate disparity between rural and urban areas charged by Small Incumbent Local Exchange Carriers (hereafter referred to as Small ILECs) that are subject to rate-of-return regulation.

Decision ("D.") 18-01-011 approved an all-party Settlement Agreement in Cal-Ore Telephone Company's (Cal-Ore) general rate case (GRC) for rates effective February 1, 2018. This decision's Ordering Paragraph (O.P.) 8 required Cal-Ore to submit an advice letter informing the Commission of any income tax change within 30 days of its effective date. [1]
The Tax Cut and Jobs Act of 2017 (TCJA) was signed into law on December 22, ~~2017~~2017, and became effective January 1, 2018. Among other things, the TCJA reduced the top corporate income tax rate from 35% to 21%.[2]

[1] On January 11, 2018, the Commission issued D.18-01-011 and ordered that if Cal-Ore's then-current income tax rate changes on or after January 1, 2018 and after the decision is issued in this case, Cal-Ore shall file a Tier 2 Advice Letter with revised revenue requirement within 30-days of the tax change taking effect.

[2] Cal-Ore's adopted revenue requirement for TY 2018 per D.18-01-011 was based on a 34% federal income tax rate.

~~Accordingly, on~~On January 31, 2018, Cal-Ore filed a Tier 2 Advice Letter (AL) 378 proposing an adjustment in its revenue requirement applicable to taxable operating revenue to reflect the impact of the TCJA. Specifically, Cal-Ore proposed a $71,253 decrease from the approved revenue requirement of $3,144,624 and an equal $71,253 decrease from the CHCF-A support of $1,469,711 approved in D.18-01-011, resulting in a revenue requirement of $3,073,371 and CHCF-A support of $1,398,371 for 2018. Cal-Ore did not propose any other adjustments.

~~In May 2018, the Small ILECs submitted a letter to the Communications Division's Director, citing a material change in the National Exchange Carrier Association's (NECA) interpretation of how federal rules are to apply to deferred tax calculations in light of the TCJA.[3] NECA works with the Federal Communications Commission (FCC) and is responsible for interpreting federal separations and accounting requirements. The letter revised/updated previous guidance that it provided to carriers in a January 2018 letter. The new NECA interpretation instead requires regulated utilities to "follow the normalization method of accounting and flow back the excess deferred taxes ratably over the life of the timing difference that gave rise to the excess."~~

Notice/Protest

The Commission Daily Calendar published Notice of AL 378 on February 2, 2018. The Office of Ratepayer Advocates (ORA) filed a protest to AL 378 on February 20, 2018.
ORA indicated that: (1) Cal-Ore did not include all necessary adjustments to accurately reflect changes to the federal income tax rate; (2) Cal-Ore proposed a revenue requirement that could result in excess revenue and excess CHCF-A support; and (3) that Cal-Ore should calculate excess deferred tax reserve to be "flowed through" back to the ratepayers.

Cal-Ore responded to ORA's protest on February 28, 2018 stating that AL 378 was properly supported and submitted. Cal-Ore claims that ORA's protest has no merit and should be rejected.

DISCUSSION

Staff's Review of Cal-Ore's Methodology

~~Staff has reviewed Cal-Ore's AL 378 and observes that~~ Cal-Ore calculated the new federal income tax by adjusting the operating tax expense and deferred (income) tax reserve at the new 21% tax rate and ~~then applying~~applied this adjustment to reduce the level of the

[3] ~~See Appendix B.~~

CHCF-A operating revenues. Under Cal-Ore's method, the recalculated income tax caused a $71,253 reduction in Cal-Ore's revenue requirement for TY 2018 from $3,144,624 to $3,073,371, and the equal amount of reduction in Cal-Ore's CHCF-A support for TY 2018 from $1,469,711 to $1,398,458.

~~While Cal-Ore appropriately accepts the reduced corporate tax rate of 21% for operating tax expense, its treatment~~Cal-Ore's methodology ignores the full impact on deferred income taxes and is incorrect on two fronts. First, Cal-Ore's method omits the return of *any* excess deferred taxes to ratepayers. Second, Cal-Ore's method does not address excess deferred taxes from the rate base reduction.

Deferred income taxes for ratemaking represent funds that ratepayers have provided to the utility for income taxes presumably to be paid in the future, due to timing differences between straight line depreciation for ratemaking and accelerated depreciation for income tax filings. Through 2017, ~~these balances were~~Cal-Ore accumulated a fund balance using the prevailing tax rate of 34% ~~for Cal-Ore~~. Once the federal income tax rate was reduced to 21%, a lower amount of ratepayer funds ~~are~~is needed to pay those future tax liabilities, and thus these excess funds should be returned to Cal-Ore's ratepayers.

Furthermore, Cal-Ore's methodology would be contrary to ~~Commission~~Internal Revenue Service (IRS) normalization rules ~~if it were to be adopted~~, as Cal-Ore's method effectively reduces the excess tax reserve to zero instantly. Under normalization rules, excess deferred taxes should instead be flowed through ratably over the life of the timing difference that gave rise to the excess. Consequently, the impact of reducing past accumulated excess deferred taxes should increase the projected tax savings.

In May 2018, the Small ILECs submitted a letter to the Communications Division's Director, citing a material change in the National Exchange Carrier Association's (NECA) interpretation of how federal rules are to apply to deferred tax calculations in light of the TCJA.[3] NECA works with the Federal Communications Commission (FCC) and is responsible for interpreting federal separations and accounting requirements. The letter revised/updated previous guidance that it provided to carriers in a January 2018 letter. The new NECA interpretation instead requires regulated utilities to "follow the normalization method of accounting and flow back the excess deferred taxes ratably over the life of the timing difference that gave rise to the excess."

Therefore, Staff concludes that a further reduction in Cal-Ore's revenue requirement ~~from the TCJA~~is needed to account for the change in excess deferred taxes ~~according to~~consistent with

[3] See Appendix B.

normalization rules~~ is needed~~.[4] NECA's revised interpretation ~~also~~of the federal tax change and deferred taxes supports ~~a further~~the adjustment ~~for deferred taxes according to normalization rules~~as well. Moreover, we have consulted with the Energy and Water Divisions to develop consensus that deferred taxes should be further adjusted consistent with the methodology described here.[5]

Staff's Calculation

Staff ~~has~~ recalculated the tax impact of the TCJA to include the excess deferred tax impact. Prior to the enactment of the TCJA, Cal-Ore's deferred income tax liability balance was $1,182,356. On January 1, 2018, the new tax rate of 21% resulted in deferred income tax of $730,279 causing an excess deferred tax reserve of $452,077. This $452,077 should be returned to ratepayers ratably over the remaining life of the assets that gave rise to the excess tax reserve balance. The TCJA provides guidance for the return of the excess deferred tax reserve under normalization rules.[6] In summary, the TCJA rules say that if the excess deferred taxes are to be reduced, they should be reduced no faster than using the average rate assumption method (ARAM). ~~But if the utility does not have the appropriate vintage data to use ARAM, an alternative method based on a composite rate is allowed.~~[7]

~~As a result~~Accordingly, Staff ~~recommends~~has adjusted the $452,077 excess deferred income tax reserve ~~should be~~and returned it to ratepayers over the weighted average of the remaining useful life of Cal-Ore's depreciable assets as of December 31, 2017. Appropriately, as the excess deferred tax reserve is returned to Cal-Ore's ratepayers, rate base will be incrementally increased by $33,737 per year (as the $452,077 excess remaining in the deferred tax account will be incrementally decreased as it is returned to ratepayers).

To calculate the additional increment for excess deferred tax, Staff relied on ~~information obtained through a data request on April 11, 2018, specifically requesting~~ the weighted average remaining life of Cal-Ore's depreciable assets, which Cal-Ore states is 13.4 years, based on an April 11, 2018 data request response from data request response from the company. Staff amortized the excess deferred income tax reserve of $452,077, dividing that

[4] Staff also corrects for Cal-Ore's removal of the entire excess deferred tax balance from rate base.

[5] Energy Division agrees with CD's proposed methodology. Water Division's methodology is quite similar, but further considers changes to franchise fees and uncollectibles, which is not a material factor for communications companies.

[6] Internal Revenue Code Sec. 168(f)(2) contain normalization requirements.

[7] Section 13001(d) of the Tax Cuts and Jobs Act of 2017 P.L. 115-97. "The average rate assumption method is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes."

amount by 13.4 years to arrive at a credit of $33,737 per year beginning TY 2018. Staff added this amount as a credit to the federal tax ~~amount~~obligation.

Staff incorporated its methodology and updated the effects of excess deferred tax by line item, which required further steps to reconcile the Results of Operations Table ~~in~~(See Appendix A column C~~,~~), so that the Total (Revenue Requirement) of $2,987,818 (line 8) equals the sum of Total Operating Expenses of $2,519,536 (line 18) plus Net Operating Income of $468,282 (line 19), demonstrating proof of a balanced ~~calculation:~~result. This process is outlined in Appendix C).

- ~~Staff added the first year of the incremental Excess Deferred Tax of $33,737 as a credit to the federal tax for 2018, lowering tax-related expenses (Deferred Income Tax, line 17, column C);~~
- ~~The first year of the Unamortized Excess Deferred Tax Balance ($33,737) is then subtracted from the deferred income tax reserve of $452,077 (the difference between line 26, columns A and B), which equals $418,340 in UEDTB remaining for future amortization (line 27, column C);~~
- ~~Consistent with normalization rules, Staff has reduced Cal-Ore's proposed rate base of $5,668,142 (line 29, column B) by the unamortized balance of $418,340 left on the excess deferred tax after taking the yearly income tax credit. Thereafter, the rate base will be increased yearly by the $33,737 amortized amount (see Total Rate Base, line 29, column C, $5,249,802, compared to line 29, column A, $5,216,065);~~
- ~~The Total Rate Base of $5,249,802 was then multiplied by the Rate of Return (line 30; 8.92%) equals $468,282 in Net Operating Income (line 19, column C);~~
- ~~Staff's adjustments decreased Cal-Ore's total operating expenses including income taxes by an additional $48,237 (line 18, comparing columns B and C). This is a sum of two factors: 1) a $14,500 decrease in State and Federal Income Tax (line 16, column C) and the line 17, column C deferred tax credit of $33,737;~~
- ~~To fully recover revenue requirement including the additional cost of tax liabilities, utilities incorporate a "net to gross multiplier" to account for such liabilities. Cal-Ore calculated and Staff confirms that the NTGM is 1.38857 when California's State Income Tax Rate is 8.84% and the Federal Income Tax Rate is 21%;~~
- ~~State income tax decreased by $4,581, as the product of multiplying the difference between Cal-Ore's proposed Net Operating Income of $505,598 and Staff's proposed Income of $468,282 ($37,316, line 19) by the NTGM of 1.38857; then multiplying that amount by the State Tax Rate of 8.84%;~~
- ~~Federal income tax decreased by $9,919, calculated by 1) subtracting the decrease in state income tax from the product of 2) the $37,316 difference in proposed operating income multiplied by the NTGM, and then 3) multiplying that result by the federal income tax rate of 21% (line 16, columns B and C);~~

- ~~The resulting gross reduction in Net Operating Income (line 19, $37,316) and Total Expenses (line 18, $48,237) equals $85,553, requiring a further offset to revenue requirement and CHCF-A support between Cal-Ore's and Staff's proposals;~~
- ~~Therefore, Staff proposes a further reduction of $85,553 in revenue requirement for TY 2018, from $3,073,371 to $2,987,818 (line 8, comparing Cal-Ore's proposal in column B and Staff's result in column C);~~
- ~~And Staff proposes a further reduction in CHCF-A support by an equal additional amount, from $1,398,458 to $1,312,905 (line 7, comparing columns B and C).~~

Therefore, Staff proposes a further reduction of $85,553 in revenue requirement for TY 2018, from $3,073,371 to $2,987,818 (Appendix A, line 8, comparing Cal-Ore's proposal in column B and Staff's result in column C); Staff also proposes a further reduction in CHCF-A support by an equal additional amount, from $1,398,458 to $1,312,905 (line 7, comparing columns B and C). This results in an overall decrease of $156,806 in Cal-Ore's revenue requirement, from $3,144,624 to $2,987,818 (comparing line 8, columns A and C), and a corresponding decrease of $156,806 in CHCF-A support from $1,469,711 to $1,312,905 (comparing line 7, columns A and C) for TY 2018.

Summary

~~While~~ Staff accepts Cal-Ore's calculation of the reduced tax rate of 21% ~~related to the federal income tax reduction, it~~and has further reduced Cal-Ore's proposed revenue requirement and CHCF-A support by an additional $85,553 to consider the normalization return of the excess deferred income tax. For TY 2018, Staff proposes a total decrease to Cal-Ore's adopted revenue requirement ~~by~~of $156,806, from $3,144,624 to $2,987,818. Cal-Ore proposes to reflect the reduced revenue requirement by decreasing its CHCF-A support in an equal amount. Staff agrees with this proposal since almost half of the company's revenues come from CHCF-A support. For TY 2018, Staff proposes a $156,806 decrease to Cal-Ore's adopted CHCF-A support, from $1,469,711 to $1,312,905.

COMMENTS

In compliance with P.U. Code § 311(g), the Commission emailed a notice letter on July ~~6,~~5, 2018, informing Cal-Ore of the availability of this Resolution for public comments at the Commission's website www.cpuc.ca.gov. Comments are due within twenty (20) days of Daily Calendar notification. The notice letter also informed parties that the final conformed Resolution adopted by the Commission will be posted and available at the same website.

On July 26, 2018, Cal-Ore filed timely comments on the draft Resolution. Cal-Ore argued that D.18-11-011 only mandates a modification for the "tax rate" and does not provide for any change to deferred taxes. Cal-Ore believes deferred taxes are not ratepayer property and that the draft Resolution is incorrect in stating that these amounts represent funds that should be returned to ratepayers. Further Cal-Ore argues that no decision orders "normalization" of deferred tax amounts and that forcing a credit of deferred tax amounts to ratepayers would constitute retroactive ratemaking. Finally, Cal-Ore asked for clarification that the application of deferred tax normalization policy would apply in the future whether a tax increase or decrease.

Staff examined Cal-Ore's arguments and is not persuaded that the resolution needs to be modified. The new federal income tax rate impacts more than federal tax expense and needs to be applied to all results of operations items that are tax-related. Moreover, the draft Resolution only seeks to adjust future revenue requirement and associated CHCF-A support payments consistent with the adopted settlement in D.18-11-011, so there is no retroactive ratemaking. Rather than ordering a refund, the draft Resolution is revising the revenue requirement and CHCF-A support prospectively. Finally, the Commission recognizes the practice of normalizing deferred taxes in accordance with IRS rules.[8] Likewise, the TCJA includes normalization requirement rules that govern the treatment of the excess tax reserve.[9] Nonetheless, we clarify here for Cal-Ore that federal tax rate changes in the future should be treated similarly, applying normalization to deferred taxes whether a tax increase or decrease.

FINDINGS

1. The Tax Cuts and Jobs Act of 2017 enacted on December 22, 2017, among other things, lowered the corporate federal tax rate from 35% to 21% effective January 1, 2018.
2. Cal-Ore Telephone Company's (Cal-Ore) adopted revenue requirement for Test Year (TY) 2018 pursuant to D.18-01-011 dated January 11, 2018 was based on an estimated 34% federal income tax rate.
3. Decision (D.)18-01-011 ordered Cal-Ore to submit a Tier 2 Advice Letter (AL) with a revised revenue requirement within 30 days of the tax change taking effect.
4. Cal-Ore filed Tier 2 AL 378 on January 31, 2018, revising its revenue requirement and California High Cost Fund-A (CHCF-A) support for 2018.
5. In AL 378, Cal-Ore proposed a revised revenue requirement of $3,073,371 for TY 2018, which is $71,253 lower than the D.18-01-011 adopted revenue requirement of $3,144,624.

[8] Internal Revenue Code 168(f)(2) states that the code section (use of accelerated depreciation) will not apply to any public utility property that does not use a normalization method of accounting. Therefore, public utilities must use normalization to receive the benefit of accelerated depreciation. The fact that Cal-Ore has a deferred income tax balance demonstrates that it normalizes its deferred tax.

[9] The Tax Cut and Jobs Act 13001(d).

6. In AL 378, Cal-Ore proposed a revised CHCF-A support of $1,398,458, which is $71,253 lower than the D.18-01-011 adopted CHCF-A support of $1,469,711.

7. In AL 378, Cal-Ore did not include the appropriate effect of excess deferred income tax reserve created by the lower tax rate on the revenue requirement.

8. In May 2018, the Small ILECs submitted a letter to the Communications Division Director informing that the National Exchange Carrier Association had revised its previous guidance on the treatment of excess deferred income taxes from the flow- through to the normalization method.

9. Staff received information from Cal-Ore regarding excess deferred income tax reserve through a data request dated April 11, 2018.

10. Cal-Ore should follow ~~Commission~~Internal Revenue Service normalization requirements for returning the excess deferred tax reserve to ratepayers.

11. Staff calculates that Cal-Ore's excess deferred income tax reserve is $452,077, and this amount should be amortized over the weighted-average life of Cal-Ore's depreciable assets, and be shown as a line item credit to federal income tax over 13.4 years, while keeping the unamortized balance as a rate base reduction item.

12. Staff calculates that Cal-Ore's amortized excess deferred income tax amount is $33,737 per year for 13.4 years, which further reduces Cal-Ore's revenue requirement and CHCF-A support, and this should be reflected in Cal-Ore's accounting books and its results of operations table.

13. Staff calculates that Cal-Ore's rate base should be increased (excess deferred tax balance should be decreased) per year by the $33,737 amount of excess deferred tax listed as a credit to ratepayers. This results in a 2018 rate base of $5,249,802 compared to Cal-Ore's proposed $5,668,142.

14. Staff calculates that Cal-Ore's revised revenue requirement for TY 2018 should be $2,987,818, which is $156,806 less than the previously authorized $3,144,624 in D.18-01-011.

15. Staff calculates that Cal-Ore's CHCF-A support for 2018 should be $1,312,905, which is $156,806 less than the previously authorized $1,469,711 in D.18-01-011.

16. Cal-Ore's revised revenue requirement and its revised CHCF-A support and other revenue components as shown in Column C of Appendix A of this Resolution are reasonable and should be adopted for TY 2018.

17. In compliance with P.U. Code § 311(g), the Commission emailed a notice letter on July 5, 2018, informing Cal-Ore of the availability of this Resolution for public comments at the Commission's website www.cpuc.ca.gov.

18. Cal-Ore filed comments on the draft Resolution on July 26, 2018.

THERFORE, IT IS ORDERED that:

1. Cal-Ore Telephone Company's revised adopted revenue requirement for Test Year 2018 ~~shall be~~is $2,987,818, which is $156,806 less than the previously authorized $3,144,624, as shown in Appendix A of this Resolution.

2. Cal-Ore Telephone Company's revised California High Cost Fund-A support for Test Year 2018 ~~shall be~~is $1,312,905, which is $156,806 less than previously authorized $3,144,624, as shown in Appendix A of this resolution.

3. Staff shall revise ~~Cal-Ore Telephone Company's~~the remaining monthly ~~disbursements of~~ California High Cost Fund-A support payments to Cal-Ore Telephone Company so that total 2018 payments equal $1,312,905.

4. Starting January 1, 2018, Cal-Ore Telephone Company shall show an amortized excess deferred income tax credit of $33,737 each year as a line item~~,~~ in its results of operations table under the federal income tax item for 13.4 years, until the unamortized balance remaining as a reduction to rate base is fully depleted~~, in its results of operations table under the federal income tax item starting January 1, 2018.Cal-Ore's deferred tax balance for ratemaking will contain the unamortized balance of excess deferred tax as a rate base reduction item until the excess deferred tax is fully amortized~~.

5. Cal-Ore Telephone Company's deferred tax balance for ratemaking will contain the unamortized balance of excess deferred income tax as a rate base reduction item until the excess deferred balance is fully amortized.

This Resolution is effective today.

I certify that the foregoing Resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on August 9, 2018, the following Commissioners voting favorable thereon:

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ALICE STEBBINS
Executive Director

APPENDIX

(End of Appendix A-1)

Appendix A
Cal-Ore Telephone Company
Test Year 2018
Results of Operations

		Adopted Results of Operations Per D.18-01-011	Cal-Ore Proposed Results of Operations with Tax Rate Change	T-17617 Adopted Results of Operations with Tax Rate Change	
		A	**B**	**C**	
Operating Revenues:					
1	Local Rev.	$ 712,207	$ 712,207	$ 712,207	
	Intrastate:				
2	Access Rev.	145,410	$ 145,410	$ 145,410	
3	Toll Rev.				
4	Interstate USF	767,362	$ 767,362	$ 767,362	
5	Interstate Settlement Rev.	-	-	-	
6	Miscellaneous Rev. & Uncollect	49,934	49,934	49,934	
7	CHCF-A	1,469,711	1,398,458	1,312,905	
8	**Total**	**$ 3,144,624**	**$ 3,073,371**	**$ 2,987,818**	
Operating Expenses:					
9	Plant Specific	$ 701,879	$ 701,879	$ 701,879	
10	Plt. Non-Spec.(less Depr.)	404,959	404,959	404,959	
11	Customer Operations	137,707	137,707	137,707	
12	Corporate Operations	408,959	408,959	408,959	
13	**Subtotal**	**$ 1,653,504**	**$ 1,653,504**	**$ 1,653,504**	
14	Depr. & Amort.	656,882	656,882	656,882	
15	Other Taxes	60,925	60,925	60,925	
16	State and Federal Income Tax	308,040	196,462	181,962	
17	Amortized Excess Deferred Income Tax	-	-	(33,737)	[1]
18	**Total**	**$ 2,679,351**	**$ 2,567,773**	**$ 2,519,536**	
19	**Net Operating Income**	**$ 465,273**	**$ 505,598**	**$ 468,282**	
Rate Base:					
20	2001 - TPIS	$ 19,430,432	$ 19,430,432	$ 19,430,432	
21	2003 - TPUC	-	-	-	
22	1220 - Mat. and Sup.	245,680	245,680	245,680	
23	1500 - Other Regulatory Asset	416,667	416,667	416,667	
24	Working Cash	204,990	204,990	204,990	
25	Less: Accum. Depr.	(13,899,348)	(13,899,348)	(13,899,348)	
26	Less: Deferred Inc Tax	(1,182,356)	(730,279)	(730,279)	
27	UEDTB	-	-	(418,340)	[2]
28	Less: Cust Dep.	-	-	-	
29	**Total Rate Base**	**$ 5,216,065**	**$ 5,668,142**	**$ 5,249,802**	
30	Rate of Return	8.92%	8.92%	8.92%	

[1] Line 17: This amount is to be shown for 13.4 years starting TY 2018.
[2] Line 27: UEDTB: Unamortized Excess Deferred Tax Balance at year 1 of 13.4 years. This balance will be depleted each year by $33,737.

APPENDIX B

NECA

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For your action
2018 federal tax rate change

May 8, 2018

TO: General contacts at cost companies in CL and TS pool

Due to the 2017 Tax Cuts and Jobs Act, the federal corporate tax rate changed from 35 percent to 21 percent for C Corp companies. Our January 9, 2018 letter (member login required) instructed companies on adjustments to Account 4340 as required by GAAP.

Application of tax rate changes
After further review and subsequent discussions with FCC staff, we have confirmed the proper treatment of the tax rate change for regulated entities. The FCC bases its accounting rules on GAAP to the extent regulatory considerations permit (see 47.CFR §36.1). This situation constitutes one of the variations. While flowing through the full impact of the tax rate difference in Account 4340 deferred taxes as a one-time adjustment in 2017 may be applicable for GAAP reporting purposes, regulated entities for interstate reporting must follow the normalization method of accounting and flow back the excess deferred taxes ratably over the life of the timing difference that gave rise to the excess (see, e.g., Report and Order, CC Docket No. 89-360, 9 FCC Rcd. 727 (1994) ¶ 6 and ¶ 7).

Cost study and HCLS submissions
Companies who made flow-through adjustments to Account 4340 and Account 7250 on their financials in accordance with GAAP, will need to make adjustments to data reported for 2017 cost study and 2018-1 HCLS submissions to remove the impact of flowing through the excess deferred tax. Amortization of excess deferred income taxes will be effective with the change in tax rate on January 1, 2018. 2018 cost studies and the 2019-1 HCLS submission (reflecting 2018 period ending data) will reflect amortized excess deferred taxes using the normalization method.

Additional guidance
We are currently updating NECA Reporting Guideline 3.3 Excess Deferred Tax Development, which addresses methods for calculating and amortizing excess deferred taxes as a result of the Tax Reform Act of 1986. Until the guideline is updated, you may find a review of this document (member login required) helpful in describing the calculations and reporting requirements in settlements. NECA Cost Pool Procedures will also be updated to provide instructions on EC1050 reporting of these amounts for the calculation of federal income tax.

Questions?
If you have questions, please contact your member service manager.

Sincerely,

Carol A. Brennan

Carol A. Brennan

cc: Authorized consultants

(End of Appendix B-1)

APPENDIX C – Line Item Changes to Column C, Appendix A Results of Operations

- Staff added the first year of the incremental Excess Deferred Tax of $33,737 as a credit to the federal tax for 2018, lowering tax-related expenses (Deferred Income Tax, line 17, column C);
- The first year of the Unamortized Excess Deferred Tax Balance ($33,737) is then subtracted from the deferred income tax reserve of $452,077 (the difference between line 26, columns A and B), which equals $418,340 in UEDTB remaining for future amortization (line 27, column C);
- Consistent with normalization rules, Staff has reduced Cal-Ore's proposed rate base of $5,668,142 (line 29, column B) by the unamortized balance of $418,340 left on the excess deferred tax after taking the yearly income tax credit. Thereafter, the rate base will be increased yearly by the $33,737 amortized amount (see Total Rate Base, line 29, column C, $5,249,802, compared to line 29, column A, $5,216,065);
- The Total Rate Base of $5,249,802 was then multiplied by the Rate of Return (line 30; 8.92%) equals $468,282 in Net Operating Income (line 19, column C);
- Staff's adjustments decreased Cal-Ore's total operating expenses including income taxes by an additional $48,237 (line 18, comparing columns B and C). This is a sum of two factors: 1) a $14,500 decrease in State and Federal Income Tax (line 16, column C) and the line 17, column C deferred tax credit of $33,737;
- To fully recover revenue requirement including the additional cost of tax liabilities, utilities incorporate a "net to gross multiplier" to account for such liabilities. Cal-Ore calculated and Staff confirms that the NTGM is 1.38857 when California's State Income Tax Rate is 8.84% and the Federal Income Tax Rate is 21%;
- State income tax decreased by $4,581, as the product of multiplying the difference between Cal-Ore's proposed Net Operating Income of $505,598 and Staff's proposed Income of $468,282 ($37,316, line 19) by the NTGM of 1.38857; then multiplying that amount by the State Tax Rate of 8.84%;
- Federal income tax decreased by $9,919, calculated by 1) subtracting the decrease in state income tax from the product of 2) the $37,316 difference in proposed operating income multiplied by the NTGM, and then 3) multiplying that result by the federal income tax rate of 21% (line 16, columns B and C);
- The resulting gross reduction in Net Operating Income (line 19, $37,316) and Total Expenses (line 18, $48,237) equals $85,553, requiring a further offset to revenue requirement and CHCF-A support between Cal-Ore's and Staff's proposals.

(End of Appendix C-1)

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Input:	
Document 1 ID	file://D:\q53\My Documents\Resolutions CD (2ND FOLDER2018\T-17617_Draft_Cal-Ore tax resolution with RO Table_v16_062818.docx\T-17617 Res-A Rev-1\T-17617 RES-C_Cal-Ore tax resolution with RO Table_v16_062818WS.docx
Description	T-17617 RES-C_Cal-Ore tax resolution with RO Table_v16_062818WS
Document 2 ID	file://D:\q53\My Documents\Resolutions CD (2ND FOLDER2018\T-17617_Draft_Cal-Ore tax resolution with RO Table_v16_062818.docx\T-17617 Res-A Rev-1\T-17617 Res-A Rev-1 Cal-Ore Telephone Tax ResolutionWS.docx
Description	T-17617 Res-A Rev-1 Cal-Ore Telephone Tax ResolutionWS
Rendering set	standard

Legend:	
Insertion	
~~Deletion~~	
~~Moved from~~	
Moved to	
Style change	
Format change	
~~Moved deletion~~	
Inserted cell	
Deleted cell	
Moved cell	
Split/Merged cell	
Padding cell	

Statistics:	
	Count
Insertions	80
Deletions	56
Moved from	17
Moved to	17
Style change	0
Format changed	0

Total changes	170