

**ADOPTED REGULATION OF THE
PUBLIC UTILITIES COMMISSION OF NEVADA**

LCB File No. R152-10

Effective November 1, 2012

EXPLANATION – Matter in *italics* is new; matter in brackets ~~[omitted material]~~ is material to be omitted.

AUTHORITY: §§1-12, NRS 703.025 and 704.210.

A REGULATION relating to public utilities; revising provisions relating to the adjustment of certain rates by public utilities to conform with federal tax reform; and providing other matters properly relating thereto.

Section 1. NAC 704.6508 is hereby amended to read as follows:

704.6508 “Contributions” means cash or noncash property of which the ~~[company]~~ *utility* has a beneficial use ~~[, as defined in]~~ *pursuant to* section 118 of the Internal Revenue Code ~~[of 1954.]~~, *26 U.S.C. § 118, as amended*. The term includes contributions in aid of construction and customer advances.

Sec. 2. NAC 704.6512 is hereby amended to read as follows:

704.6512 “Income tax gross up” means the ~~[net addition of revenue]~~ *additional contribution amount calculated pursuant to NAC 704.6532 which is* required ~~[due]~~ to *indemnify the utility for the* additional income tax *liability* as a result of section 118 of the Internal Revenue Code ~~[of 1954]~~, *26 U.S.C. § 118, as amended* (i.e., “related income tax impact”).

Sec. 3. NAC 704.6524 is hereby amended to read as follows:

704.6524 1. Sections 49, 59A, 118, 166, 167, 168, 172, 263A, and 451 of the Internal Revenue Code ~~[of 1954]~~ may be obtained from the Internal Revenue Service.

2. Sections 203(e), 463, and 701(a) of the Tax Reform Act of 1986 (Public Law 99-514) may be obtained from the Internal Revenue Service.

Sec. 4. NAC 704.6526 is hereby amended to read as follows:

704.6526 1. For the purpose of rate making, generally, any timing difference, excluding that associated with items previously flowed through, must be normalized at the applicable current corporate income tax rate.

2. Any item of deferred income tax that is generated and associated with items of rate base must be included in the calculation of rate base ~~+~~, *including, without limitation, any income tax gross up amounts required by NAC 704.6532.*

3. Any item of deferred income tax that is generated and associated with items of nonrate-base items must be excluded from rate base.

4. Deferred income tax balances must be adjusted to reflect changes in the statutory corporate income tax rate and these adjustments must be amortized to cost of service over a period of time to be determined by the Commission.

5. The rate-making treatment associated with items previously flowed through will be determined by the Commission on a case-by-case basis.

Sec. 5. NAC 704.653 is hereby amended to read as follows:

704.653 1. Unless otherwise ordered by the Commission, the rate to be used in the calculation of the allowance for funds used during construction will be the lesser of the gross rate computed in accordance with the provisions of Electric Plant Instructions 3(17) of the Federal Energy Regulatory Commission's Uniform System of Accounts or the current authorized overall rate of return of the utility as established by the Commission.

2. To the extent the use of avoided interest calculations pursuant to the ~~[Tax Reform Act of 1986]~~ *Internal Revenue Code* creates timing differences, deferred income tax must be calculated and included as a component of rate base.

Sec. 6. NAC 704.6532 is hereby amended to read as follows:

704.6532 1. The Commission hereby adopts by reference section 118 of the Internal Revenue Code ~~[of 1954 as amended on October 22, 1986, by the Tax Reform Act of 1986.]~~ *26 U.S.C. § 118, as amended.*

2. All contributions made pursuant to section 118 of the Internal Revenue Code ~~[of 1954]~~ will be increased ~~[to reflect the utility's income tax liability on such contributions. The]~~ *by an income tax gross up amount pursuant to this section and the utility's tariff. Except as otherwise provided in subsection 8, the income tax* gross up ~~[related to the income tax liability]~~ will be calculated under the ~~[net]~~ method as described ~~[by method one]~~ *in subsection 3* for depreciable assets and *the* method ~~[two]~~ *as described in subsection 5* for nondepreciable assets . ~~[, described in subsections 3 and 4, as approved by the Commission, except for utilities with annual contributions of less than 1 percent of total operating revenues.]~~ For rate-making purposes, contributions will be treated as described in subsection ~~[5.]~~ *7.*

3. For ~~[method one, the contribution is increased for the full amount of the federal income tax utilizing the statutory corporate rate. At the 34 percent rate, the gross up would be 1.515152 (or the reciprocal of 1 minus the marginal rate, i.e., 1 divided by 1 -.34 = 1.515152). From this gross up amount, subtract the amount calculated as the present value of future tax benefits caused by the deduction of straight line depreciation of the depreciable tax basis now afforded contributed assets under the Tax Reform Act of 1986. These calculations must be done using the statutory corporate tax rate and the currently effective interest rate set for customer deposits in~~

~~accordance with NRS 704.655.]~~ *depreciable assets, the income tax gross up percentage is the present value of the sum of annual revenue requirements associated with the inclusion of the contribution-related federal income tax amount in the rate base divided by the contribution. The contribution-related federal income tax amount is calculated by multiplying the contribution by the marginal statutory federal income tax rate for the utility. The discount rate to be used in calculating the present value of the sum of annual revenue requirements associated with the inclusion of the contribution-related federal income tax amount in the rate base is the interest rate set for customer deposits that is effective on January 1 of that year in accordance with NRS 704.655. Until the utility has recovered the contribution-related federal income tax amount through the tax benefits of accelerated depreciation on the amount of the contribution, the annual revenue requirement associated with the inclusion of the contribution-related federal income tax amount in the rate base must be calculated using the pretax authorized rate of return for the utility. Except as otherwise provided in subsection 4, the pretax authorized rate of return for the utility must be calculated using a return on equity for the utility that is increased by the statutory income tax rate applicable to the utility using the methodology set forth in subsection 5. For the purpose of calculating the income tax gross up amount for the first year, the annual revenue requirement shall be deemed to be earned at the midpoint of the year.*

4. ~~[Method two provides a formula for calculating the income tax gross up percentage for]~~

For the purpose of subsection 3, unless otherwise determined by the Commission in a water or sewer utility's general rate case, the authorized rate of return used to calculate the annual revenue requirement for the water or sewer utility shall be deemed to be 10.2 percent. This authorized rate of return is calculated by adjusting the weighted average return on equity,

which is deemed to be 6 percent, for federal income taxes. This weighted average return on equity is calculated using an equity ratio which is deemed to be 40 percent and a return on equity which is deemed to be 15 percent.

5. *For nondepreciable assets ~~[-In]~~, in addition to the contribution, the contributor pays the full income tax burden utilizing the statutory ~~[corporate]~~ income tax rate ~~[.]~~ applicable to that utility. The income tax gross up percentage is 1 divided by the difference between 1.00 and the statutory income tax rate applicable to that utility. For example, using ~~[the 34]~~ a 35 percent income tax rate, the ~~[total]~~ income tax gross ~~[.]~~ up percentage is ~~[1.515152 (the reciprocal of 1 minus the statutory tax rate, i.e.,)]~~ 1 divided ~~[(1-.34) = 1.515152].~~
~~—5.]~~ by 0.65 (1.00 - 0.35), which equals 1.538462.*

6. *The utility must file a revision to the income tax gross up percentage in its tariff annually to reflect the interest rate set for customer deposits that is effective on January 1 of that year in accordance with NRS 704.655. In addition, the utility must file a revision to the income tax gross up in its tariff when a change in one or more of the components of the income tax gross up calculation, as provided in subsection 3 or 5, would result in a change in the income tax gross up percentage of 1 percent or more.*

7. The account activity and balances resulting from accounting for the gross up on contributions would be afforded rate-making treatment. For example, ~~[increased]~~ *deferred* federal income tax *assets* that ~~[results]~~ *result* from the inclusion of the contribution and income tax gross up in taxable income would be ~~[afforded deferred income tax treatment, thereby increasing]~~ *included in the* rate base and ~~[increasing]~~ *increase* revenue requirement. Conversely, revenue requirement would be reduced as the benefit of future tax depreciation deductions

~~[reduce]~~ *reduces related* deferred taxes (i.e., rate base), ~~[or]~~ *and* as deferred income (*i.e., income tax gross up*) is amortized and recognized.

~~[6.]~~ 8. Utilities that receive annual amounts of contributions ~~[that]~~ *which* are less than 1 percent of total operating revenues *or which qualify for simplified procedures or methodologies for a change of rates pursuant to NRS 704.095* may, in lieu of an income tax gross-up method elect to use one of the following methods:

(a) Rate-base method. The amount of the contribution would not be subject to a gross up. Increased federal income tax that results from the inclusion of the contribution in taxable income would be afforded deferred income tax treatment, thereby increasing rate base. The benefit of future tax depreciation deductions are used to reduce rate base (rate-base effects are reduced to zero at the end of the related assets' tax life).

(b) Flow-through method. The amount of the contribution would not be subject to a gross up. Increased federal income tax that results from the inclusion of the contribution in taxable income would increase current federal income tax expense for rate-making purposes. Future tax depreciation benefits would reduce federal income tax expense for rate-making purposes.

Sec. 7. NAC 704.6534 is hereby amended to read as follows:

704.6534 1. This section applies only to those timing differences which are mandated to be normalized by ~~[sections 167 and 168, "Normalization Requirements," of]~~ the Internal Revenue Code . ~~[of 1954.]~~

2. Excess income tax reserves must be calculated for each vintage of assets appearing on a utility's regulated books of account. The vintages must be analyzed and computed pursuant to section 203(e) of the Tax Reform Act of 1986.

3. For those utilities which do not maintain vintage records, a reverse South Georgia method may be used to amortize excess deferred income tax reserves if the use of that method is approved by the Internal Revenue Service.

4. The Commission hereby adopts by reference section 203(e) of the Tax Reform Act of 1986.

Sec. 8. NAC 704.6536 is hereby amended to read as follows:

704.6536 1. To the extent losses from the operation of a business are the result of differences unrelated to timing, the effects of carrybacks or carryovers pursuant to section 172 of the Internal Revenue Code, *26 U.S.C. § 172, as amended*, must not be considered in determining income taxes in a test year in rate proceedings.

2. The Commission hereby adopts by reference section 172, “Net Operating Loss ~~Carrybacks and Carryovers,~~ *Deduction*,” of the Internal Revenue Code ~~of 1954,~~ *26 U.S.C. § 172, as amended*.

Sec. 9. NAC 704.6538 is hereby amended to read as follows:

704.6538 The Commission hereby adopts by reference section 263A, “~~Uniform~~ Capitalization ~~Rules,~~ *and Inclusion in Inventory Costs of Certain Expenses*,” of the Internal Revenue Code ~~of 1954, as enacted on October 22, 1986, by the Tax Reform Act of 1986,~~ *26 U.S.C. § 263A, as amended*.

Sec. 10. NAC 704.6542 is hereby amended to read as follows:

704.6542 1. The Commission hereby adopts by reference ~~section 701(a),~~ *sections 53, “Credit for Prior Year Minimum Tax Liability,” and 55*, “Alternative Minimum Tax ~~,~~ *Imposed*,” of the ~~Tax Reform Act of 1986, as enacted on October 22, 1986,~~ *Internal Revenue Code, 26 U.S.C. §§ 53 and 55, as amended*.

2. For the purposes of rate making, incurrence of a minimum tax must not be included in the determination of income tax expense for the cost of service.

3. When establishing the net-to-gross multiplier, the income tax rate to be used is the statutory rate by reference to section 11 of the Internal Revenue Code ~~[of 1954,]~~, *26 U.S.C. § 11, as amended.*

4. Since the amount paid as minimum tax in any one year can be carried forward as a credit against future years' income tax liabilities, the actual amount paid must be recorded as prepaid tax and included in the cash working capital component of rate base.

Sec. 11. NAC 704.6544 is hereby amended to read as follows:

704.6544 1. The Commission hereby adopts by reference section 59A of the Internal Revenue Code ~~[of 1954,]~~, *26 U.S.C. § 59A, as amended*, which establishes a fund for the environmental tax to clean up hazardous substances through ~~[1991, as enacted on October 23, 1986, by the Tax Reform Act of 1986.]~~ *1995.*

2. For the purposes of rate making, this excise tax must be reflected in the utility's cost of service.

Sec. 12. NAC 704.652 and 704.654 are hereby repealed.

TEXT OF REPEALED SECTIONS

704.652 “Total income tax gross up” defined. (NRS 703.025, 704.210) “Total income tax gross up” means the contribution plus the additional revenue requirements taking into consideration federal income taxes (i.e., “contribution plus related income tax impact”).

704.654 Repeal of investment tax credit. (NRS 703.025, 704.210) The Commission hereby adopts by reference section 49 of the Internal Revenue Code of 1954, “Repeal of Investment Tax Credit,” as enacted on October 11, 1986, by the Tax Reform Act of 1986.

INFORMATIONAL STATEMENT

LEGISLATIVE REVIEW OF ADOPTED REGULATIONS AS REQUIRED BY NRS 233B.066 LCB FILE R152-10 (DOCKET NO. 10-02027)

The following informational statement is submitted for adopted amendments to Nevada Administrative Code Chapters 703 and 704.

1. A description of how public comment was solicited, a summary of public response, and an explanation how other interested persons may obtain a copy of the summary.

Copies of the proposed regulations, notice of intent to act upon the regulation and notice of workshop and hearing were sent by U.S. mail and email to persons who were known to have an interest in the subjects of noticing and interventions. These documents were also made available at the website of the Public Utilities Commission of Nevada (“PUCN”), <http://puc.nv.gov>, mailed to all county libraries in Nevada, published in the following newspapers:

Ely Times
Las Vegas Review Journal
Nevada Appeal
Reno Gazette Journal
Tonopah Times-Bonanza

and posted at the following locations:

Public Utilities Commission
1150 East William Street
Carson City, Nevada 89701

Public Utilities Commission
9075 W. Diablo Drive, Suite 250
Las Vegas, Nevada 89148

First Judicial District Court
885 East Musser Street
Carson City, Nevada 89701

Second Judicial District Court
75 Court Street
Reno, Nevada 89501

Eighth Judicial District Court
Regional Justice Center
200 Lewis Avenue
Las Vegas, Nevada 89155

Nevada Bell Company d/b/a AT&T Nevada and AT&T Wholesale, Central Telephone Company d/b/a CenturyLink and CenturyTel of the Gem State Inc. d/b/a Century Link, Howard Hughes Company, LLC and Howard Hughes Properties, Inc., Sierra Pacific Power Company d/b/a/ NV Energy and Nevada Power Company d/b/a NV Energy, Nevada Tri-

Partners, the Regulatory Operations Staff of the Commission, Southern Nevada Home Builders Association, and Southwest Gas Corporation provided comments.

Copies of the transcripts of the proceedings are available for review at the offices of the PUCN, 1150 East William Street, Carson City, Nevada 89701 and 9075 W. Diablo Drive, Suite 250, Las Vegas, Nevada 89148.

2. **The number of persons who:**
 - (a) **Attended each hearing:** June 28, 2012 – 1; July 26, 2012-16
 - (b) **Testified at each hearing:** June 28, 2012 – 0; July 26, 2012-8
 - (c) **Submitted to the agency written comments:** 6

3. **For each person identified in subparagraphs (b) and (c) of paragraph 2, the following information if provided to the agency conducting the hearing:**
 - (a) **Name;**
 - (b) **Telephone number;**
 - (c) **Business address;**
 - (d) **Business telephone number;**
 - (e) **Electronic mail address; and**
 - (f) **Name of entity or organization represented**

<p>Roger Moffitt 645 East Plumb Lane Rm. B132 Reno, Nevada 89502 (775) 333-3114 Roger.moffitt@att.com Nevada Bell Company d/b/a AT&T Nevada and AT&T Wholesale</p>	<p>William Kockenmeister P.O. Box 19023 Reno, Nevada 89511 775-815-5511 lbdask6@charter.net Clark County</p>
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<p>John Brownrigg 9075 W. Diablo Drive, Suite 250 Las Vegas, Nevada 89148 (702) 486-7241 jbrownrigg@puc.nv.gov Public Utilities Commission of Nevada</p>	<p>Catherine M. Mazzeo 5241 Spring Mountain Road P.O. Box 98510 Las Vegas, Nevada 89146 (702) 876-7250 catherine.mazzeo@swgas.com Southwest Gas Corporation</p>
<p>Lisa Moses 5241 Spring Mountain Road P.O. Box 98510 Las Vegas, Nevada 89146 lisa.moses@swgas.com Southwest Gas Corporation</p>	<p>Jeff Neal Applied Utility Services 7651 North Jones Blvd. Las Vegas, Nevada 89131 (702) 794-0117 Southern Nevada Home Builders Association</p>

4. A description of how comment was solicited from affected businesses, a summary of their response, and an explanation how other interested persons may obtain a copy of the summary.

Comments were solicited from affected businesses in the same manner as they were solicited from the public.

The summary may be obtained as instructed in the response to question #1.

5. If the regulation was adopted without changing any part of the proposed regulation, a summary of the reasons for adopting the regulation without change.

The permanent regulations were adopted on August 30, 2012. Changes were made to the proposed regulations.

6. The estimated economic effect of the adopted regulation on the businesses which it is to regulate and on the public. These must be stated separately, and each case must include:

- (a) Both adverse and beneficial effects; and**
- (b) Both immediate and long-term effects.**

(a) Both adverse and beneficial effects:

The Commission opened a rulemaking to consider revising the Nevada Administrative Code (“NAC”) 704.6502, 704.6532, and 704.6546 and related sections of the NAC regarding tax gross-up of contributions in aid of construction (“CIAC Tax Rate”). The proposed regulations codify existing practices and procedures with respect to the CIAC Tax Rate and clarify references to the Internal Revenue Code. The CIAC Tax Rate is a reimbursement to the utility for the time value of money. The utility takes the CIAC into taxable income in Year One and then has a corresponding tax deduction over the next 20 years. The proposed regulations that have been used since 1989, rather than the calculation in existing regulations, best balance the allocation of costs associated with the dedication of facilities for utility use between the cost-causer (i.e., the developer) and ratepayers. The proposed regulations take into account the full costs of the CIAC Tax Rate by incorporating a number of factors, including the present value of the future tax benefits using straight line depreciation, the utility’s rate of return, and accelerated tax depreciation. Because of the various components involved, a developer could experience higher or lower CIAC Tax Rate depending on changes to one or more of the components.

(b) Both immediate and long-term effects:

See Item # 6(a).

7. The estimated cost to the agency for enforcement of the adopted regulation.

There is no anticipated change in cost associated with implementing the regulation, as the methodology proposed to be adopted has been used since 1989.

8. A description of any regulations of other state or government agencies which the proposed regulation overlaps or duplicates and a statement explaining why the

duplication or overlapping is necessary. If the regulation overlaps or duplicates a federal regulation, the name of the regulating federal agency.

These regulations do not overlap or duplicate any federal, state, or local regulations.

- 9. If the regulation includes provisions that are more stringent than a federal regulation which regulates the same activity, a summary of such provisions.**

N/A

- 10. If the regulation provides a new fee or increases an existing fee, the total annual amount the agency expects to collect and the manner in which the money will be used.**

N/A

- 11. If the proposed regulation is likely to impose a direct and significant economic burden upon a small business or directly restrict the formation, operation or expansion of a small business? What methods did the agency use in determining the impact of the regulation on a small business?**

The PUCN has determined that the proposed regulations do not impose a direct and significant economic burden upon a small business or restrict the formation, operation or expansion of a small business. In making this determination, the PUCN adopted the findings of Staff, which conducted a Delphi Method exercise to determine the impacts. The Delphi Method is a systematic, interactive, forecasting method based on independent inputs of selected experts.