

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

LCB File No. R152-10

Docket No. 10-02027

October 21, 2010

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

AUTHORITY: NRS 703.025, 704.210

A REGULATION relating to the Public Utilities Commission of Nevada; regarding tax gross-up of contributions in aid of construction.

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

NAC 704.6508 "Contribution(s)" defined. Contribution(s) 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~~. The term includes contributions in aid of construction and customer advances.

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

NAC 704.6512 "Income tax gross up" defined. "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~~ (i.e., "related income tax impact").

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

NAC 704.6524 Provisions obtainable from Internal Revenue Service.

1. Sections 49, 59A, 118, 166, 167, 168, 172, 263 A, 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 704.6256 is hereby amended to read as follows:

NAC 704.6526 Rules for rate making.

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. *Pursuant to NAC 704.6532, when applicable, income tax gross up accounts related to Contributions must also be included in rate base.*
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:

NAC 704.653 Calculation of allowance for funds used during construction; inclusion of deferred income tax as component of rate base.

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:

NAC 704.6532 Contributions to corporate capital.

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~~.
2. All ~~e~~ Contributions made pursuant to *said* section 118 of the Internal Revenue Code ~~of 1954~~ will be increased to reflect the utility's *estimated* income tax liability ~~on such contributions~~ *pursuant to the utility's Nevada tariff. Except as provided in subsection 6, ~~T~~ the*

income tax gross up ~~[related to the income tax liability]~~ will be calculated ~~[under the net method as described by]~~ *using a ratio developed by the* method ~~[one]~~ *set forth in subsection 3* for depreciable assets and *the* method ~~[two]~~ *set forth in subsection 4* 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, ~~[e]~~Contributions will be treated as described in subsection 5.

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.]~~

In regard to depreciable assets, the ratio is the present value of the sum of annual revenue requirements associated with the inclusion of the Contribution related federal income tax amount (i.e., Contribution multiplied by the utility's statutory income tax rate) in rate base. The discount rate is the customer deposit rate. Until the utility has recovered the tax amount through the tax benefits of accelerated depreciation on the amount of the Contribution, the annual revenue requirement associated with the rate based Contribution related federal income tax amount shall be calculated using the pre-tax authorized rate of return for the utility. For the first year, the gross up shall be calculated with the revenue requirement earned at the mid-point of the year. Annually, the utility shall calculate the income tax gross up rate using the January 1 customer deposit rate as the discount rate. For purposes of this regulation, the authorized rate of return for water and sewer utilities shall be 10.2% (i.e. 60% debt at 7%; 40% equity at 15%), unless otherwise determined by the Commission in a utility's general rate case.

4. ~~[Method two provides a formula for calculating the income tax gross up percentage for]~~ *As to* nondepreciable assets~~[-, [H]~~in addition to the ~~[e]~~Contribution, the contributor pays the full income tax burden utilizing the statutory ~~[corporate]~~ income tax rate. *The income tax gross up percentage is 1 divided by the difference between 1.00 and the statutory income tax rate.* 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 by .65 (1.00 – ~~34~~.35), *which equals* = 1.~~515452~~538462~~{}.~~

5. 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 result~~s~~ from the inclusion of the ~~{}Contribution~~ and income tax gross up in taxable income would be *included in* ~~afforded deferred income tax treatment, thereby increasing~~ rate base and *increases* ~~increasing~~ revenue requirement. Conversely, revenue requirement would be reduced as the benefit of future tax depreciation deductions reduces *related* deferred ~~income~~ taxes (i.e., rate base), ~~or~~ *and* as deferred income is amortized and recognized.

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

(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:

NAC 704.6534 Normalization of timing differences.

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:

NAC 704.6536 Net operating loss carrybacks and carryovers.

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 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," of the Internal Revenue Code ~~[of 1954].~~

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

NAC 704.6538. Uniform capitalization rules.

The Commission hereby adopts by reference section 263A, "Uniform Capitalization Rules," of the Internal Revenue Code ~~[of 1954, as enacted on October 22, 1986, by the Tax Reform Act of 1986].~~

Sec. 10. NAC 704.654 is hereby amended to read as follows:

NAC 704.654. Repeal of investment tax credit.

The Commission hereby adopts by reference *the repeal of* section 49 of the Internal Revenue Code ~~[of 1954, "Repeal of Investment Tax Credit," as enacted on October 11, 1986, by]~~ *pursuant to* the Tax Reform Act of 1986.

Sec. 11. NAC 704.6542 is hereby amended to read as follows:

NAC 704.6542 Alternative minimum tax.

1. The Commission hereby adopts by reference sections ~~[701 (a),]~~ *53 and 55 related to* "Alternative Minimum Tax," of the ~~[Tax Reform Act of 1986, as enacted on October 22, 1986]~~ *Internal Revenue Code.*

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].~~

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 a prepaid tax and included in the cash working capital component of rate base.

Sec. 12. NAC 704.6544 is hereby amended to read as follows:

NAC 704.6544 Environmental tax.

1. The Commission hereby adopts by reference section 59A of the Internal Revenue Code ~~[of 1954]~~, 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]~~.

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

Sec. 13. NAC 704.652 is hereby repealed.

NAC 704.652 "Total income tax gross up Contribution" defined.

"Total income tax gross up" means the contribution plus the additional revenue requirement taking into consideration federal income taxes (i.e., "contribution plus related income tax impact").