

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

LCB File No. R152-10

March 28, 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 *estimated* income tax liability ~~[on such contributions. The]~~ *pursuant to the utility's Nevada tariff. Except as otherwise provided in subsection 6, 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 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, 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.]~~ *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 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 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 pre-tax authorized rate of return for the utility. For the first year, the income tax gross up must be calculated using the annual revenue requirement that has been earned at the midpoint of the year. For the purpose of this subsection, the authorized rate of return used to calculate the annual revenue requirement for water and sewer utilities shall be deemed to be 10.2 percent unless otherwise determined by the Commission in the utility's general rate case.*

4. ~~[Method two provides a formula for calculating the income tax gross up percentage for]~~ *For nondepreciable assets ~~[. In]~~, in addition to the 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 ~~[(1-.34) = 1.515152).]~~ by 0.65 (1.00 - 0.35), which equals 1.538462.*

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 ~~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* 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 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, 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.]~~

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.