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**BY EMAIL and RESS**

December 11, 2016
Our File No. 20160077

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

**Attn: Kirsten Walli, Board Secretary**

Dear Ms. Walli:

**Re: EB-2016-0077 – Horizon 2017 Rates – Further Submissions**

We are counsel for the School Energy Coalition. Pursuant to Procedural Order #2, this letter constitutes SEC's further submissions with respect to the calculation of the Earnings-Sharing Mechanism.

The Board will be aware that SEC did not make submissions on this issue initially. Our reading of the evidence was that the Applicant had received in 2015 a tax refund from a prior year, and so it properly had nothing to do with 2015. It is now not clear that our read of the evidence was correct.

SEC has reviewed the Reply Submissions of the Applicant, as well as the pre-filed evidence and the interrogatory responses in light of those submissions. Based on that, SEC submits that the adjustment to tax proposed by the Applicant should not be allowed unless it can be shown to have been part of the recalculation of tax for a prior year (i.e. a refund cheque), rather than a prior year credit applied to 2015 (i.e. part of the 2015 tax return).

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However, in our view the issue is both unique, and difficult, and it is not clear to us whether the Board has sufficient evidence on which to reach a decision on this point.

To assist the Board, we offer the following submissions:

1. ***The Settlement Agreement.*** The Settlement Agreement does not provide for adjustments for out of period tax impacts. On this point, OEB Staff is correct. However, it is also true that the Settlement Agreement does not deal specifically with adjustments to the tax calculation like prior period tax credits. An interpretation of the Settlement Agreement that concludes that out of period tax adjustments are prohibited could only be based on the theory that only adjustments specifically approved are allowed. That is the theory in the OEB Staff submissions. In our view, the clear intent of the Settlement Agreement is that ROE is to be calculated on a regulatory basis, using the normal rules for calculating regulatory income.

2. ***The RRR Interpretation.*** The Applicant appears to take the position that the words in the Agreement *"regulatory income will be calculated, for the purpose of earnings sharing, in the same manner as net income for regulatory purposes under the RRR filings"* mean that if the tax credits were not in the tax calculation filed by the Applicant in EB-2014-0002, then they cannot be in the tax calculation for ESM purposes. That interpretation is not correct, for at least two reasons:

    a. That would mean that any tax credits relating to 2015 expenditures would not be applied to the tax calculation for ESM purposes, unless they were in the forecast of 2015 tax credits in EB-2014-0002. Forecast would trump reality. The Filing Guidelines are not intended to be interpreted in that manner.

    b. The Applicant did not in fact make an adjustment to the tax calculation in 2015 in the RRR filings, as shown in Table 35.

    The Applicant's argument relating to the RRR reference can only stand if it can be shown that the credits in question would not have been relevant in the calculation of tax for 2015 had they been known at the time of the EB-2014-0002 proceeding. If they would have been excluded (as not relevant) in a cost of service calculation, then the RRR reference would imply that they should be excluded in an ESM calculation. As noted above, that is the only interpretation of the Agreement that makes sense. However, the Applicant has provided no evidence that the tax credits, if known at the time of the revenue requirement calculation in the cost of service application, would have been excluded from the calculation of 2015 tax.

3. ***What Year's Taxes are Affected?*** The evidence in this proceeding does not provide sufficient information to know whether the tax credits in question are the result of a reassessment of a prior year's tax liability (and a refund for that year), or are the result of a claim in the current year by the Applicant for credits related to

amounts spent in a prior year. In the RRR 2.1.5.6 filing, the issue is referred to as a reassessment of a prior year, and at page 44 of the Application it is referred to as a "refund", which implies that it was a reassessment of a prior year's tax liability. On the other hand, if it was the result of a reassessment of prior year tax (as opposed to prior year credits available in 2015), why would it be a part of the 2015 tax calculation in the first place? The evidence does not allow the Board to determine the basis of the credit's relevance to 2015. This is the key to the issue, because:

a. If the tax "credits" were received by way of a refund cheque in 2015 because of a reassessment of a prior year's tax liability, then in our view they should never have been part of the 2015 tax calculation. They are just a receipt of a prior period amount, and have no relevance to 2015, essentially like payment of a receivable. On an accrual basis, they relate to the prior year. To test that, look at the opposite situation. If CRA claimed that the Applicant had under-calculated their 2014 taxes, and sent them a bill in 2015 for $550,000 as a result of a reassessment of 2014, neither SEC nor the Board would see that as an amount to be added to taxes payable for the calculation of the 2015 ESM. It is a 2014 tax, and should be part of the 2014 tax calculation. A refund works the same way. The rule is symmetrical. Reassessments usually relate to the year being reassessed, not the year in which they are made.

b. Conversely, if the tax credits are being claimed on the 2015 tax return because of prior year expenses, then the appropriate comparison is to a loss carryforward being applied to the current year. The Board has been clear that, for ratemaking purposes, a reduction in current year taxes, as a result of carrying forward a loss from a prior year, reduces revenue requirement in a cost of service calculation. For the same reason, a loss carryforward would also reduce tax, and increase ROE, for earnings sharing purposes. The fact that the prior period tax benefit is a tax credit rather than a loss carryforward does not appear to us to make the tax credit different. It is still a prior period tax benefit being applied to a current year tax calculation. It should be included in the ROE calculation as a reduction of the tax payable in 2015.

c. The conclusion in (b) would be true whether or not the credit arises because of a prior year reassessment (e.g. affecting future tax credits available), or simply arises by operation of law because some credits cannot be utilized when earned. The question to be asked is "Which's year's taxes are being reassessed?" If a reassessment of 2014 results in lower taxes payable in 2014, that relates to 2014 taxes. If a reassessment of 2014 results in a tax credit being available in 2015, then that tax credit relates to 2015 taxes, not 2014 taxes.

d. As an aside, we note that a reassessment of a prior year that only affects the tax liability related to that prior year (as set out in (a) above), has a special meaning in this case because the prior year in question was an IRM year prior to a rebasing. By way of example, if in the 2016 ESM calculation, a similar adjustment is proposed relating to a reassessment for 2015, the analysis would be different. The tax credits in that case would have to be part of either the 2015 or the 2016 ESM calculation. They would not be excluded entirely because of the difference in years. The only issue would be which of two ESM years would be affected.

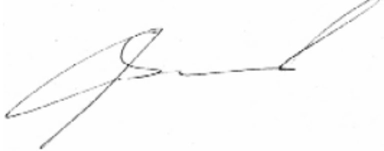
SEC has reviewed the evidence in this proceeding, and cannot find any evidence that makes clear whether the $550,218 of tax credits at issue here were a reassessment of the tax owing for a prior year, or were in fact an adjustment to the Applicant's 2015 tax return. If they were the former, then in our view they are a proper adjustment to the ESM calculation, i.e. excluded from the 2015 tax calculation because they are part of the tax calculation for a prior year. If they were the latter, i.e. credits applicable to 2015 taxes, then they should be used to reduce 2015 tax for ESM purposes. In short, on which tax return do the tax credits properly appear: 2015, or some prior year?

In theory, the Board could simply deny the adjustment proposed in this proceeding by the Applicant, on the basis that the onus is on the Applicant, and the Applicant has not shown that the reassessment it refers to created a reduction in tax for a prior year. Given how late it is in the process, that would be a reasonable decision by the Board.

SEC believes, instead, that the Board should allow the Applicant to file documentary evidence showing the precise nature of the tax credits, and their applicability to either 2015 taxes or taxes for a prior year. The additional evidence should also be subject to discovery, if that proves necessary. Based on that evidence, it should be possible for the Board to determine the true tax calculation for 2015, and thus whether the tax credits in question are properly part of that calculation, or not.

All of which is respectfully submitted.

Yours very truly,
**JAY SHEPHERD P. C.**



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cc: Wayne McNally, SEC (email)
Interested Parties