

UNDERTAKING J15.2

Undertaking

To advise why the four material risks associated with the proposed tax variance account were chosen and to rank in order of importance.

Response

OPG identified four types of events on pages 14 and 15 of Ex. J1-T3-S1 that would be captured in the proposed tax variance account. These events are essentially the same as the types of events in section 1592 of Article 220 of the Uniform System of Accounts for Electricity Distributors. Each of these types of events could be potentially significant, they are beyond management's ability to control, they are reasonably likely to occur during the test period, and they can not be forecast with a reasonable degree of accuracy.

OPG believes that all four factors in its proposed tax variance account are important. However, for purposes of this undertaking, OPG has ranked the factors in order of anticipated importance during the test period based on the potential financial impact and likelihood of occurrence. The ranking is as follows: (1) tax reassessments, (2) new assessing policy or court decision, (3) tax rate or rule change, and (4) municipal property tax changes.

OPG has also highlighted its rationale for requesting a variance account that captures these events below. The risks that OPG faces in this area are equal to or greater than those faced by the Electricity LDCs, for whom the OEB has already established Account 1592.

1. Tax Assessments or Reassessments

The Canadian income tax system is a self assessing system, i.e., taxpayers calculate their own taxable income and income tax, payable based on the statutory tax rates in effect, and submit the information and payment to the taxing authorities. The taxing authorities, do however, reserve the right to audit the taxpayer and the result could be a change in the taxable income and the taxes payable for that year. A change to taxable income is not necessarily restricted to the year under audit as it could relate to an item that recurs annually or is carried forward to future years. Large corporations such as OPG are generally subject to audit on all taxation years and changes in any of these years could potentially have an impact on the taxable income and the taxes payable for all subsequent years. The Ontario Ministry of Finance, which is OPG's taxing jurisdiction, is now finishing the audit of OPG's initial year, i.e., 1999. OPG reflected the expected impacts of this reassessment in the March 2008 update to its rate application. As subsequent audits are undertaken, there is a possibility that the Ministry may take a position on certain items that differs from the position that OPG has taken in its application and therefore, could change the taxable income and tax expense of that year and subsequent years. The variance account for potential reassessments that OPG is seeking would record the impact of any such adjustments on the tax losses for the

1 period April 1, 2005 to April 1, 2008, as well as the taxable income for the period after
2 April 1, 2008.

3 4 2. Administrative Policy Changes and Court Decisions

5 From time to time, the federal and provincial tax authorities issue interpretation bulletins
6 and administrative policies that interpret how legislation is to be applied. These changes
7 can impact the tax expense included in OPG's revenue requirement.

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9 In addition to administrative policy changes, court judgments on other taxpayers can
10 impact the tax rules applicable to OPG. Unlike changes to legislation, which are applied
11 prospectively, changes resulting from court decisions can be applied retroactively
12 because of the length of time it takes for tax cases to be heard and judgments issued. In
13 view of this, any judgment that impacts OPG's calculation of regulatory taxable income
14 in the test period could potentially also impact the tax losses generated in the period April
15 1, 2005 to April 1, 2008, which are being applied to reduce payment amounts in the test
16 period. OPG is therefore requesting a variance account in order to capture the revenue
17 requirement impact of this risk.

18 19 3. Legislative or Regulatory Changes to Tax Rates or Rules

20 Statutory tax rates that apply to OPG's taxable income are found in the *Income Tax Act*
21 (Canada) and the *Corporations Tax Act* (Ontario) and these rates can only be changed
22 through the legislative process. Changes to the statutory tax rates are generally
23 announced in the annual budget papers and therefore theoretically, can happen every
24 year. Although this is not normally the case, there have been a number of changes in the
25 past few years. OPG has estimated the income tax payable on the 2008 and 2009
26 regulatory earnings before tax based on the statutory tax rates currently in place,
27 however, the government budgets for 2009 could potentially change the statutory tax
28 rates. Therefore the income taxes that OPG incurs on the regulatory earnings before tax
29 for those years could potentially be different from the amount reflected in OPG's revenue
30 requirement. OPG has no control over the statutory tax rates and a change in these
31 rates could have a large impact on OPG's tax expense. The variance account requested
32 by OPG would ensure that the actual statutory rates applicable to the income for that
33 year are taken into account.

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35 In addition to changes to tax rates, other changes can arise as a result of a change in
36 legislation. Changes to provisions in the legislation are generally prospective, but they
37 are not normally known in advance of being announced. OPG's determination of
38 regulatory taxable income for 2008/2009 is based on current legislation (including
39 proposed changes to capital cost allowance regulations that have not yet been enacted),
40 and changes to legislative provisions for these years could result in the regulatory
41 taxable income for those years being different than the amount on which OPG's revenue
42 requirement is calculated.

43 44 4. Municipal Taxes

45 The variance account being requested for the differences in municipal property taxes
46 that result from a change in the tax rates or rules follow the same reasoning as the
47 income taxes articulated above.