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VIA E-MAIL AND WEB POSTING

November 21, 2007

To: All Licensed Electricity Distributors
All Participants in Proceedings EB-2006-0087, EB-2006-0088 and EB-2006-0089

**Re: Cost of Capital (EB-2006-0088) and 2nd Generation Incentive Regulation Mechanism (EB-2006-0089)
Adjustment to 2008 IRM Applications to Reflect Changes in Corporate Income Taxes**

The federal government announced in an Economic Statement on October 30, 2007 that the federal income tax rates for corporations will be reduced. The changes are expected to be approved before the House rises, and the new income tax rates would be effective January 1, 2008.

In its December 20, 2006 report entitled "Report of the Board on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors", the Board addressed the issue of dealing with extraordinary events outside the control of electricity distributors' management (Z-factors). In particular, the Board stated Z-factors would apply to changes in tax rules that may result in positive or negative amounts.

This letter describes how the Board intends to effect income tax rate changes as part of the 2008 Incentive Regulation Mechanism (2008 IRM) application process.

Adjustment to 2008 IRM Applications to Reflect Changes in Corporate Income Taxes

Since the release of the 2008 IRM spreadsheet model (the model) preceded the announcement of the federal government to adjust corporate income taxes, and given that the vast majority of electricity distributors have already submitted their 2008 IRM applications, the Board intends to make subsequent adjustments to the model submitted by distributors. This will be done at the same time that the final 2007 GDP-IPI value will be effected in the model, and will be reflected in the Decisions that will be issued by the Board.

The details on how the Board intends to quantify the effect in rates of the reduced corporate taxes effective January 1, 2008 are found in Appendix A of this letter.

If you have any questions regarding this letter, please e-mail the Board at EDR@oeb.gov.on.ca. The Board's toll-free number is 1-888-632-6273, and the Market Operations Hotline is 416-440-7604.

Yours truly,

Original signed by

Kirsten Walli
Board Secretary

Attachment: Appendix A – Income Tax Change Calculation

Appendix A
Income Tax Change Calculation
Cost of Capital (EB-2006-0088) and 2nd Generation Incentive Regulation
Mechanism (EB-2006-0089)

The 2008 price cap will be adjusted as follows to reflect the new income tax rates effective January 1, 2008.

For distributors with taxable income above \$400,000 and \$1,128,519 for federal and Ontario income tax purposes respectively:

In the 2006 electricity distribution rate (2006 EDR) applications, an effective tax rate of 36.12% was used. Since the IRM price cap formula does not explicitly adjust for changes in income tax rates, distribution rates implicitly include a tax/PILs expense recovery based on that level.

Since the new federal income tax rate for larger companies will be 19.5% for 2008 and the Ontario income tax rate is 14%, the new combined income tax rate will be 33.5% - a difference of 2.62% from the 36.12% level embedded in the rates used in the existing 2008 IRM model.

This difference of 2.62% will be applied to the taxable income calculated in the 2006 EDR application, and will be further grossed up by the reciprocal of the new combined tax rate of 33.5%. This dollar amount will be expressed as a percentage of the 2006 EDR distribution revenue requirement. The resulting percentage will be applied uniformly to the monthly service charge and volumetric rate for all customer classes.

For distributors with taxable income at or below \$400,000:

In the 2006 EDR applications, an effective tax rate of 18.62% was used. Since the IRM price cap formula does not explicitly adjust for changes in income tax rates, distribution rates implicitly include a tax/PILs expense recovery based on that level.

Since the new federal income tax rate for smaller distributors will be reduced to 11% in 2008 and the Ontario income tax rate is 5.5%, the new combined income tax rate will be 16.5% - a difference of 2.12% from the 18.62% level embedded in the rates used in the existing 2008 IRM model.

This difference of 2.12% will be applied to the taxable income calculated in the 2006 EDR application, and will be further grossed up by the reciprocal of the new combined tax rate of 16.5%. This dollar amount will be expressed as a percentage of the 2006 EDR distribution revenue requirement. The resulting percentage will be applied uniformly to the monthly service charge and volumetric rate for all customer classes.

For distributors with taxable income between \$400,000 and \$1,128,519:

The income tax rate used in the 2006 EDR applications varied from 27.62% to 36.12%. The same calculations described above will be applied to determine the adjustment required to the 2008 price cap adjustment.