LG&E ENERGY

LG&E Energy LLC
220 West Main Street (40202)
P.O. Box 32030
Louisville, Kentucky 40232

January 20, 2006

RECEIVED

JAN 20 2006

PUBLIC SERVICE COMMISSION

Ms. Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

RE: ***Adjustment of Electric Rates, Terms and Conditions of Kentucky Utilities Company***
Case No. 2003-00434

Dear Ms. O'Donnell:

Enclosed please find an original and six (6) copies of Kentucky Utilities Company's ("KU") response to the Rehearing Data Request of the Commission Staff dated January 6, 2006 in the above-referenced docket.

Should you have any questions concerning the enclosed, please do not hesitate to contact me at (502) 627-3324.

Sincerely,

Robert M. Conroy
Manager, Rates

cc: Parties of Record

In December 2005, LG&E Energy LLC was renamed E.ON U.S. LLC

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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JAN 20 2006

PUBLIC SERVICE
COMMISSION

In the Matter of:

ADJUSTMENT OF ELECTRIC RATES,	)	CASE NO.
TERMS AND CONDITIONS OF KENTUCKY	)	2003-00434
UTILITIES COMPANY	)	

RESPONSE OF
KENTUCKY UTILITIES COMPANY
TO THE
REHEARING DATA REQUEST OF THE COMMISSION STAFF
DATED JANUARY 6, 2006

FILED: JANUARY 20, 2006

KENTUCKY UTILITIES COMPANY

CASE NO. 2003-00434

Response to Rehearing Data Request of the Commission Staff Dated January 6, 2006

Question No. 1

Responding Witness: S. Bradford Rives

Q-1. During this proceeding, KU has opposed the use of the effective Kentucky corporate income tax rate to determine the tax expense resulting from its pro forma adjustments. Is this still KU's position? Explain the response.

A-1. Yes, this is still KU's position. KU continues to believe it is reasonable to use the statutory Kentucky Corporate Income Tax Rate. KU's operations are primarily in the state of Kentucky, and when jurisdictionalized, nearly 97% of KU's income is subject to the Kentucky Corporate Income Tax Rate. This rate is objective, known and measurable, readily verifiable and is unlike the effective tax rate which fluctuates from year to year based on changes in property, payroll and sales factors.

KENTUCKY UTILITIES COMPANY

CASE NO. 2003-00434

Response to Rehearing Data Request of the Commission Staff Dated January 6, 2006

Question No. 2

Responding Witness: S. Bradford Rives

Q-2. Refer to KU's Response to the Commission July 26, 2004 Order, Item 2. In that response, KU stated that the effective Kentucky income tax rate was 7.98 percent. However, KU has argued in this proceeding that a combined income tax rate, reflecting Virginia and Tennessee tax rates as well as Kentucky tax rates, should be used.

a. Provide the calculations used to determine the effective Kentucky income tax rate of 7.98 percent.

b. Provide the combined Kentucky-Virginia-Tennessee effective income tax rate, including all calculations used to determine the rate.

c. In the response to Item 2, KU determined that the difference in the "Overall Revenue Deficiency" using the 7.98 percent income tax rate was $416,109. Using the format shown in the response to Item 2, provide the calculation of the difference in the "Overall Revenue Deficiency" using the combined Kentucky-Virginia-Tennessee effective income tax rate, as determined in part (b) above. Include any supporting calculations, workpapers, or assumptions used in calculating the difference.

A-2. a. See attached. This rate represents KU's Kentucky jurisdiction only and excludes the Virginia and Tennessee jurisdictional activities. This rate is appropriate for KU as it matches the company's activities that benefit Kentucky customers with the state income tax cost of only those activities.

State income tax filings in Kentucky, Virginia, and Tennessee begin with the entire income of the corporation and apportion the income on a three factor formula of sales, property and payroll to determine the income attributable to their state. Under this approach, in addition to being taxed in Kentucky, the Kentucky jurisdictional income is also subject to Virginia and Tennessee income taxes on an apportioned basis. Similarly, Virginia and Tennessee income is also subject to Kentucky taxes, on an apportioned basis. Using an effective rate on a jurisdictional basis is appropriate for KU as no Virginia or Tennessee taxes are included. Only the state income tax cost of serving the Kentucky customers is included.

b. See attached. The combined Kentucky-Virginia-Tennessee effective income tax rate is 7.90%. This rate combines apportioned income taxes from each state excluding coal or other tax credits. The use of a combined state income tax is not appropriate for KU since its Virginia and Tennessee activities benefit customers in either Virginia or Tennessee and provide no benefit to the Kentucky customers. This is unlike LG&E where both in-state and out-of-state activities benefit Kentucky customers.

c. See attached. The difference in the "Overall Revenue Deficiency" using the Kentucky only effective income tax rate of 7.90% is $538,928. However, as discussed in Response Item No. 1 above, KU believes the Kentucky statutory income tax rate is appropriate for the KU Kentucky jurisdictional customers. The application of either a jurisdictionalized effective income tax rate or a combined state income tax rate results in an insignificant difference for this case and should not be considered.

Kentucky Utilities Company
2002 State Apportionment--KY Jurisdiction

		KENTUCKY JURIS
1	Sales Factor (Double Weighting)	187.10%
2	Property Factor	100.00%
3	Payroll	100.00%
4	Total	387.10%
5	Apportionment Factor (total / 4)	96.77%
6	Statutory Kentucky Income Tax Rate	8.25%
7	Effective Income Tax Rate	7.98%

		KY Return	VA Return	TN Return	KY Juris
8	Sales Numerator	741,783,653			741,783,653
9	Sales Denominator	835,204,526	42,272,442	2,727	792,929,357
10		88.815%	0.000%	0.000%	93.550%
11	Double Weighting	2	2	2	2
12	Sales Factor	177.63%	0.00%	0.00%	187.10%
13	Property Numerator	2,538,337,702			2,538,337,702
14	Property Denominator	2,636,044,827	97,455,642	251,483	2,538,337,702
15	Property Factor	96.29%	0.00%	0.00%	100.00%
16	Payroll Numerator	59,626,063			59,626,063
17	Payroll Denominator	61,838,712	2,212,649	0	59,626,063
18	Payroll Factor	96.42%	0.00%	0.00%	100.00%

Kentucky Utilities Company
Combined State Income Tax Rate

KU	Kentucky 2002	Virginia 2002	Tennessee 2002	Total 2002
1 State Taxable Income	142,588,232	142,510,240	142,588,232	
2 State Apportionable Income	132,016,883	6,102,716	3,009	
3 State Tax	10,891,393	366,163	296	
4 Credits (Coal)	411,853			
5 State Tax after Utilized Credits	10,479,540	366,163	296	
6 Effective Rate excluding Credits	7.64%	0.26%	0.00%	7.90%
7 Effective Rate including Credits	7.35%	0.26%	0.00%	7.61%

Kentucky Utilities Company
Revenue Deficiency at 7.90% Effective Tax Rate

State Tax Rate	Co Eff Rate 7.90%	Difference
1 Net Operating Income per books	86,471,474	303,943
2 PSC ordered adjustments	(41,182,942)	
3 Federal and State income tax on adjustments	16,528,774	(93,691)
4 Other tax adjustments	(377,258)	(1,727)
5 Total Rate Case Adjustments (Line 2+3+4)	(25,031,426)	(95,418)
6 Adjusted Net Operating Income (Line 1+5)	61,440,048	208,525
7 Net Operating Income found Reasonable	90,793,892	
8 Adjusted Net Operating Income (Line 6)	61,440,048	
9 Net Operating Income Deficiency (Line 7-8)	29,353,844	
10 Gross Up	0.5961818	
11 Overall Revenue Deficiency (Line 9/10)	49,236,399	538,928
12 Incremental "gross-up" adjustment (Line 11-6)		330,403

KENTUCKY UTILITIES COMPANY

CASE NO. 2003-00434

Response to Rehearing Data Request of the Commission Staff Dated January 6, 2006

Question No. 3

Responding Witness: S. Bradford Rives

Q-3. On page 10 of the Rebuttal Testimony of S. Bradford Rives is the statement that KU pays Virginia and Tennessee income taxes.

a. Describe the transactions on which KU pays Virginia income taxes.

b. Describe the transactions on which KU pays Tennessee income taxes.

A-3. Corporations such as KU are subject to tax in governmental jurisdictions where they have "nexus" with that particular jurisdiction. Nexus is sometimes defined as "a connection or link" and is often interpreted by states to be a physical or economic presence within their borders. Levels and frequency of economic activities, owning or renting property or inventory, and the presence of employees or contractors are typical indicators of nexus. Once a corporation is determined to have nexus, tax returns such as income, sales/use, property, etc. are required.

KU has both a physical and economic presence in Kentucky, Virginia and Tennessee and is subject to tax in all three states. Since customers and property of all three jurisdictions are part of the Kentucky Utilities Company, income from all three groups of customers is initially combined for purposes of determining income taxes due to each state. Further information regarding Virginia and Tennessee taxation is discussed in a and b below.

a. KU annually files a Virginia income tax return and reports taxable income that has been apportioned based on the percentage of sales, property, and payroll in Virginia compared to sales, property and payroll everywhere. This method does not tax specific transactions, but taxes portions of all company taxable income based on this apportionment concept.

b. KU annually files a Tennessee Franchise, Excise Tax Return and reports taxable income and net worth that has been apportioned based on the percentage of sales, property, and payroll in Tennessee compared to sales, property and payroll everywhere. This method does not tax specific transactions, but taxes portions of all company taxable income and net worth based on this apportionment concept.

KENTUCKY UTILITIES COMPANY

CASE NO. 2003-00434

Response to Rehearing Data Request of the Commission Staff Dated January 6, 2006

Question No. 4

Responding Witness: S. Bradford Rives

Q-4. The pro forma adjustments as determined by the Commission in its June 30, 2004 Order were related to KU's jurisdictional operations. If the income taxes KU pays in Virginia and Tennessee are related to its operations in those states, explain in detail why KU believes a combined Kentucky-Virginia-Tennessee income tax rate should be used to determine the Kentucky jurisdictional income tax expense resulting from Kentucky jurisdictional pro forma adjustments.

A-4. As outlined in Q-3 above, KU's total company income is apportioned based on the percentage of sales, property, and payroll in Virginia and Tennessee compared to sales, property and payroll everywhere. This method does not tax specific transactions, such as off-system sales or specific property in another jurisdiction, but taxes portions of all company taxable income based under this apportionment concept. KU believes the jurisdictional approach produces the most accurate measure of the Kentucky customers' state income tax costs. This approach segregates the Kentucky jurisdictional income from non-Kentucky customers' income and expenses before applying state income taxes. The use of a combined rate produces a similar result, however, Kentucky, Virginia and Tennessee jurisdictional income would be inappropriately subject to all three state taxes on an apportioned basis. Since Virginia and Tennessee activities do not benefit the Kentucky ratepayers, no state income tax resulting from those activities should be borne by the Kentucky ratepayers.