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Witness:	Melissa K. Hardesty
Type of Exhibit:	Rebuttal Testimony
Sponsoring Party:	Kansas City Power & Light Company
Case No.:	ER-2012-0174
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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2012-0174

REBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

Kansas City, Missouri
September 2012

"[redacted]**" Designates "Highly Confidential" Information Has Been Removed.**
Certain Schedules Attached To This Testimony Designated ("HC") Have Been Removed Pursuant To 4 CSR 240-2.135.

REBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

Case No. ER-2012-0174

Q: Please state your name and business address.

A: My name is Melissa K. Hardesty. My business address is 1200 Main Street, Kansas City, Missouri, 64105.

Q: Are you the same Melissa K. Hardesty who pre-filed Direct Testimony in this matter?

A: Yes, I am.

Q: What is the purpose of your Rebuttal Testimony?

A: The purpose of my testimony is to rebut direct testimony provided by Missouri Public Service Commission Staff's ("Staff") witnesses Charles R. Hyneman concerning Kansas City Earnings Tax and amortization of Investment Tax Credit ("ITC"), and Cary G. Featherstone concerning qualifying advanced coal project credits for the Iatan Unit 2 facility.

<u>KANSAS CITY EARNINGS TAX</u>

Q: What is the purpose of this portion of your testimony?

A: I will explain why Kansas City Power & Light Company's ("KCP&L" or the "Company") method of calculating Kansas City, Missouri Earnings Tax expense ("KCMO Earnings Tax", "Earnings Tax" or "city tax") based on Missouri jurisdictional ratemaking taxable income is more appropriate than Staff's method of including Earnings

Tax expense using actual amounts paid based on the filed total company Earnings Tax return.

Q: Why is the Company's calculation of KCMO Earnings Tax more appropriate than Staff's method?

A: There are several reasons. First, the Company's method calculates the amount as an income tax expense that varies based on changes to taxable income. Second, it calculates the amount based on the same Missouri jurisdictional taxable income that is used to calculate both federal and state income tax expense for the rate case. Finally, it recognizes that Earnings Tax must be calculated and paid on the increased revenue requirement that will be authorized in this case.

Q: Why is the Earning Tax calculated as an income tax?

A: The annual Earnings Tax return begins with the same federal taxable income that is used for both the federal and state income tax returns. The only material adjustment to federal taxable income is an adjustment to eliminate interest income. For the 2010 return, interest income of $1.1 million was eliminated. The Earnings Tax is simply a city income tax, consistent with the definition of the Missouri or Kansas taxes as state income taxes.

Q: Does the Earnings Tax expense vary directly based on increases or decreases to taxable income?

A: Yes, it does.

Q: Why should the Earnings Tax be calculated based on the taxable income derived by both Staff and KCP&L, as reflected on Schedule 11 included in each party's accounting schedules?

A: Again, there are several reasons. Taxable income for ratemaking purposes can be significantly different from taxable income used in the Company's filed federal, state and city tax returns. For ratemaking purposes, depreciation expense is based on a straight line amount whereas the federal, state and city tax returns use accelerated depreciation amounts, including the component known as "bonus depreciation" authorized at either 50% or 100% rates through 2012. Another difference is the significantly higher deduction for maintenance costs resulting from tax return deductions for components known as "repair allowance" and "repair expense," neither of which are current deductions for ratemaking. There are a large number of other differences between taxable income for ratemaking and taxable income for tax return purposes, including the treatment of a growing number of regulatory assets and liabilities, interest expense, pensions, advertising expense and charitable contributions. Many of the major differences are listed on Schedule MKH-3 attached to this testimony.

Q: Why do these differences matter?

A: All elements of cost of service should be calculated consistently, based on the treatment of those costs for ratemaking purposes. It would be improper to require that Earnings Tax for ratemaking purposes be calculated based on taxable income that includes deductions that are not allowed for ratemaking.

Q: Why is it proper to calculate an earnings tax impact for the authorized revenue requirement?

A: The revenue requirement reflects the additional revenue that the Company will be authorized to collect with the implementation of new rates. The Company will have to include these new revenues in its subsequent Earnings Tax returns and incur the associated Earnings Tax expense.

Q: How does Staff include KCMO Earnings Tax in its Revenue Requirement Model?

A: Staff has included the Earnings Tax expense in its revenue requirement model based on the amount of Earnings Tax paid by or refunded to the Company during the test year.

Q: What amount does Staff include in its Missouri jurisdictional cost of service in this case?

A: The Staff did not make any adjustments to the KCMO Earnings Tax recorded during the test period in its filed revenue requirement schedules. Based on the test period there is a negative $427,000 included for KCMO Earnings Tax in that revenue requirement. However, Staff indicated in its Cost of Service Report that it intended to adjust the KCMO Earning Tax number to reflect $0. Subsequent to its direct filing, Staff corrected its accounting schedules accordingly.

Q: Has Staff indicated to you why it believes its method is appropriate?

A: Staff indicated in its Cost of Service Report that because the Company is not presently incurring a cash payout to Kansas City, Missouri, the Company should not be entitled to include any amount in cost of service.

Q: Does Staff make adjustments for the differences between costs deductible for ratemaking and those deductible on the Earnings Tax return?

A: No, it does not.

Q: Why do you believe Staff's approach for the calculation of Earnings Tax is incorrect?

A: Primarily, Staff does not recognize the significant differences between taxable income for ratemaking purposes and taxable income for tax return purposes. Also, Staff's method does not recognize that Earnings Tax will vary directly based on increases or decreases to Missouri jurisdictional taxable income. Both of these reasons were discussed above.

Q: Is there another reason?

A: Yes. The KCP&L Earnings Tax return is prepared on a total KCP&L basis. Consequently, there are both revenues and deductions that are 100% Kansas jurisdictional just as there are other revenues and deductions that are 100% Missouri jurisdictional. Many of these components are the result of varying ratemaking treatments authorized by the Missouri Public Service Commission ("MPSC" or the "Commission") and by the Kansas Corporation Commission ("KCC"). The amount of Earnings Tax should be based solely on Missouri jurisdictional taxable revenues and deductions.

Q: Would you provide a few examples?

A: The MPSC requires the Missouri jurisdictional portion of margins on off-systems sales over a stated threshold to be deferred and returned to ratepayers over ten years. It also requires that demand-side management customer program costs be deferred when incurred and recovered over ten years. For the Earnings Tax return, deferred Missouri jurisdictional excess margins, net of amortizations, are included in taxable income when incurred while deferred Missouri jurisdictional program costs, net of amortizations, are deducted when incurred. The KCC authorized a rider for Kansas jurisdictional customer program costs, with a deferral period of only one calendar year. The Company also has an energy adjustment clause for its Kansas jurisdiction. The Earnings Tax return includes an adjustment to recognize fuel costs that have been incurred but not yet collected from Kansas ratepayers.

Q: How was Earnings Tax treated in prior rate cases?

A: Prior to KCP&L's 2007 rate case, Case No. ER-2007-0291, KCP&L treated Earnings Tax as a general tax and did not adjust it. Staff treated Earnings Tax as an income tax on its EMS Schedule 11 that varied based on changes to Missouri jurisdictional taxable income for ratemaking. As part of Case No. ER-2007-0291, Staff suggested and KCP&L agreed that the Company would treat Earnings Tax as an income tax. Based on calculations at the time, the parties agreed that the 1% Earnings Tax rate would be applied to 65% of the Missouri jurisdictional taxable income, resulting in a weighted .65% tax rate (65% x 1%).

Q: How was the .65% Earnings Tax rate derived?

A: At the time of the agreement, the allocation factor used on the KCP&L Earnings Tax return was 36.15%, meaning that 36.15% of the Company's total taxable income, including amounts pertaining to its Kansas jurisdiction, was attributable to taxable income from inside the Kansas City, Missouri city limits. For ratemaking, however, the Earnings Tax would be calculated on only the Missouri jurisdictional taxable income. Consequently, the 36.15% needed to be converted from a total company factor to a Missouri jurisdictional factor. To accomplish this, the Earnings Tax factor was divided by the allocation factor represented by Missouri jurisdictional taxable income divided by total company taxable income, where both amounts represented taxable income for ratemaking purposes.

Q: Has the factor changed in the intervening years?

A: The Company has not changed the factor since the initial agreement. However, the allocation factor in the 2010 Earnings Tax return was 35.2033%. Based on the Annual Surveillance Report submitted for 2010, Missouri jurisdictional taxable income divided by total company taxable income would be 53.10%. Dividing 35.2033% by 53.10% would result in a new factor of 66.3%, representing the portion of Missouri jurisdictional taxable income that was incurred within the Kansas City, Missouri city limits.

Q: Would the Company be willing to use an updated Earning Tax factor of 66.3% rather than 65%?

A: Yes, it would. This would result in a tax rate to be applied to Missouri jurisdictional taxable income for ratemaking purposes of 1% x .66.3% = .663%

Q: Is an accumulated deferred income tax reserve applicable to this item included in rate base?

A: No.

Q: Why not?

A: The Company adopted the method used by Staff, which only applied the Earnings Tax rate to the taxable income used to calculate currently payable income taxes for ratemaking. The Staff used an effective tax rate that was based on only federal and state income tax rates when calculating deferred income tax expense. Because neither the Staff nor the Company included recovery for deferred income tax expenses related to the

Earnings Tax in its cost of service, no associated accumulated deferred income tax reserve was created.

Q: Is it theoretically correct to exclude the Earnings Tax component from the calculation of deferred income tax expense and what is its impact?

A: No, it would be theoretically more correct to apply the effective income tax rate including Earnings Tax when calculating both the currently payable and deferred income tax expense components. The deferred income tax expense is routinely a positive expense, because the accelerated depreciation used in the current payable calculation is higher than the straight line depreciation used in the resulting income tax calculation. Both the Staff and the Company have consistently understated deferred income tax expense included in cost of service for ratemaking purposes.

Q: Does the Company intend to begin calculating deferred income tax expense on Earnings Tax differences for ratemaking versus the filed Earnings Tax return?

A: No. It would be difficult to change the methodology at this time due to the turn-around of deferred income tax reserves previously recognized. To change the method on a prospective basis, there would need to be established separate recordkeeping for cumulative deferred income taxes. The Company would need to segregate existing and future deferred income tax reserves and expense into two categories: 1) where the Earnings Tax rate was applied when the associated deferred income taxes were provided, versus 2) those where the Earnings Tax rate was not applied.

Q: What is the dollar impact of the calculation of Earnings Tax based on the Earning Tax return versus the amount when the Earnings Tax is calculated based on Missouri jurisdictional taxable income for ratemaking?

A: Schedule MKH-4 shows the impact of the major differences for 2006 through 2010. The 2011 return was not completed when this testimony was written, although we expect the impact to be even greater for 2011 due to the impact of depreciation differences in 2011. To make the comparison on Schedule MKH-4, it was assumed that, unless noted, all of the deductions on the Earning Tax return would be allocated to the Missouri jurisdiction using the 53.5% demand factor used in Case No. ER-2010-0355. 100% Missouri items such as the increased return deduction for Iatan 2 and Iatan 1/Common costs deferred for ratemaking were not allocated. 100% Kansas items such as the increased return deduction for Iatan 1/Common costs deferred for ratemaking were ignored. As you can see from Schedule MKH-4, the amount of Earnings Tax based on ratemaking treatment would be $495,000 higher for 2010 than for the return.

Q: What is the value of this issue in this case?

A: Because Earnings Tax is itself deductible for federal and state income tax purposes, it is clearest to compare effective income tax rates both with and without Earnings Tax. Including Earnings Tax, the total effective income tax rate would be 38.79% using calculations provided by Staff in conjunction with Case No. ER-2009-0089. Without Earnings Tax, the effective income tax rate would be 38.39%, a difference of .40%. This difference must be applied to both the adjusted Missouri jurisdictional taxable income on the Company's Schedule 11, as projected to the August 31, 2010 true-up date, as well as to the Company's revenue requirement, also projected to August 31, 2012. When this is done, the Company's request for Earning Tax is valued at $721,000, 100% Missouri jurisdictional.

Q: Is the method proposed for KCP&L also being proposed for either the KCP&L Greater Missouri Operations Company ("GMO") Missouri Public Service ("MPS") or KCP&L Greater Missouri Operations Company St. Joseph Light & Power ("L&P") jurisdictions?

A: No. For KCP&L, approximately 65% of its Missouri jurisdictional taxable income is derived from inside the Kansas City, Missouri city limits. The percent for both the MPS and L&P jurisdictions is insignificant, making the impact immaterial.

Q: Does Staff recommend any other changes to how KCMO Earnings Taxes are computed?

A: Yes. Mr. Hyneman has also indicated in the Staff's Cost of Service report that the Earnings Tax is a right to do business in the City of Kansas City, MO and that some of the Earnings Tax expense should be allocated to KCP&L Kansas customers and to GMO customers.

Q: Do you agree with Mr. Hyneman that some of the Earnings Tax should be allocated to Kansas KCP&L customers and to GMO customers?

A: No. The Earnings Tax is already computed based on an apportionment of taxable earnings to Kansas City, Missouri and does not require an additional allocation to KCP&L Kansas and GMO customers.

Q: How is the apportionment to Kansas City, Missouri for Earnings Tax calculated?

A: The apportionment used for KCMO Earnings Tax returns consists of an equal weighting of three factors: payroll, property and revenue. These factors are computed by taking the amount of payroll, property or revenue located or generated in Kansas City, Missouri divided by total payroll, property or revenue, respectively for KCP&L. On the 2010 return, the payroll factor was 41.6312%, the property factor was 22.3489% and the revenue factor was 41.6297%. No revenue from KCP&L Kansas or GMO customers is included in the revenue factor and the other two factors which provide support to all of KCP&L's customers are approximately equal to or less than the revenue factor. The three factors are then added together and divided by three to get the overall apportionment factor. The overall apportionment factor on the 2010 return was 35.2033%. The 2011 return has not been completed at this time, but will be available when the true-up is prepared. Therefore, the Company expects to use the 2011 return apportionment factor to compute Earnings Tax at that time.

Q: Does the apportionment factor calculated per KCP&L Earnings Tax return reflect an appropriate amount of Earnings Tax for Missouri customers?

A: Since the property and payroll factors, which include employees and property used for all KCP&L customers, are approximately equal to or less than the revenue factor, it is the Company's position that the apportionment factor to KCP&L Missouri customers is not overstated. However, if the Commission believes that a different method should be used to compute the Earning Tax related to Kansas City, Missouri-only customers, then a separate computation of taxable income based on revenue and deductions includible for ratemaking purposes for Kansas City, Missouri customers should be done, with the 1% earnings tax applied to calculate the Earnings Tax includible in this case.

AMORTIZATION OF ITC

Q: What is the purpose of this portion of your testimony?

A: I will explain why the Company did not reflect the full amount of ITC amortization that may be available to KCP&L if it had filed a "stand-alone" KCP&L federal income tax return.

Q: Does KCP&L file a "stand-alone" federal income tax return or as part of a "consolidated" federal tax return with Great Plains Energy Incorporated ("GPE") and other affiliated subsidiaries?

A: KCP&L files its federal income tax return as a part of the consolidated GPE and subsidiaries federal income tax return.

Q: How long has KCP&L been filing its federal income tax return as part of a consolidated group?

A: The Company is unable to determine exactly when KCP&L started filing a consolidated return, but we were able to determine that it has filed a consolidated return with other subsidiaries for several decades prior to the creation of GPE and the reorganization of the companies into the current corporate structure in 2001. The current GPE consolidated group is considered a continuation of the KCP&L consolidated group for federal income tax purposes.

Q: Do you agree that KCP&L should use the traditional "stand-alone" method for calculating the amount of income taxes to be incorporated in the rates of a regulated utility company?

A: Generally, the Company does agree that the "stand-alone" method for calculating the amount of income taxes incorporated in the rates of a regulated utility company is appropriate and is not asking for this method to be changed. However, the Company believes that it would violate the Internal Revenue Code's "normalization requirements" for ITC if it computed the amount of amortization for ITC based on the amount of ITC that would have been utilized to offset federal tax liabilities of KCP&L on a "stand-alone" basis instead of the amount of ITC utilized to offset the GPE and subsidiaries federal tax liability on a consolidated basis.

Q: **Are all other income tax amounts calculated on a "stand-alone" basis other than the amount of amortization of ITC?**

A: Yes. All other income tax related items included in rate base or cost of service are calculated on a "stand-alone" basis.

Q: **What is the Internal Revenue Code's "normalization requirement" for ITC?**

A: Any public utility that claims ITC for public utility property must use "normalization" accounting in calculating the rates to be charged to its customers.

Q: **What is "normalization" accounting?**

A: Under normalization accounting, the immediate flow-through of the tax benefits of ITC on public utility property to the customers is prohibited. Instead, under former Internal Revenue Code Section 46(f)(2), a utility defers the ITC it claims for federal tax purposes and then amortizes it ratably over the regulatory life of the assets generating ITC.

Q: **Has the IRS issued any guidance related to "normalization requirement" for amortization of ITC for credits that have not been used to offset federal liabilities?**

A: The normalization rules related to this situation have been interpreted by the Internal Revenue Service ("IRS") in Private Letter Ruling 9309013 ("PLR 9309013"). In PLR 9309013, the IRS indicates that if ITC that is carried forward is amortized for ratemaking purposes before the ITC is used as an offset against federal income tax liabilities, the normalization requirements would be violated. A copy of PLR 9309013 is attached as Schedule MKH-5.

Q: What are the penalties imposed by the IRS for violating the normalization requirement for ITC?

A: As stated in the Direct and Rebuttal Testimony of Company witness, Salvatore Montalbano, Congress mandated certain penalties in Section 211(b) of the Tax Reform Act of 1986. The penalty is the recapture and payment to the IRS of the greater of ITCs claimed in any open tax years or any unamortized ITC remaining on its regulated books. The Company would also be prohibited from claiming any future ITC credits on its federal income tax return until the violation of the normalization requirement is corrected.

Q: How much unamortized ITC is remaining on KCP&L's regulated books?

A: As of December 31, 2011, KCP&L had $127.9 million of unamortized ITCs.

Q: Why would the Company violate the normalization requirement if the ITC amortization is calculated on a "stand-alone" basis versus on a "consolidated" basis?

A: KCP&L would have been able to use more ITC to offset its federal tax liabilities if it was allowed to calculate the amount of ITC on a "stand-alone" or separate company basis versus the amount that it has actually used to offset federal tax liabilities on the GPE consolidated tax return. Since the amortization of ITC on a stand-alone basis would be more than the amount on a consolidated basis, the Company believes this would be more than ratable based on the IRS' interpretation of the normalization rules for ITC in PLR 9309013 and would therefore be a normalization violation.

Q: Did KCP&L calculate the amortization of ITC based on what was utilized to offset federal tax liabilities on a consolidated basis in Case No. ER-2010-0355?

A: No. Unfortunately, the Company was not aware of the requirement that ITC should only be amortized beginning when it has been used to offset federal tax liabilities until it was too late to incorporate it into the rate case. The Company began amortizing the full amount of ITC in the last rate case.

Q: Did the Company violate the normalization requirement for ITC in the last case?

A: No. The IRS has ruled in several private letter rulings that the harsh sanctions of disallowance or recapture of the ITC should be imposed, if at all, only after a regulatory body has required or insisted upon such treatment by a utility. Since, neither the Company, nor the Staff, was aware of the issue until it was too late in the regulatory process to correct the amount of amortization of ITC, the Company believed that there was no requirement by a regulatory agency to flow the ITC through at a faster rate than permitted.

Q: Did the Company ask the IRS to confirm that there was no violation in the last case?

A: Yes. KCP&L filed a request with the IRS for a private letter ruling on December 11, 2011. The private letter ruling requested that the IRS confirm that KCP&L did not have a violation of the ITC normalization requirement.

Q: Did the IRS issue a private letter ruling confirming that there was no violation?

A: Yes. The IRS issued a Private Letter Ruling 150025-11, IRS Letter Ruling 201230021, ("PLR 150025-11") on May 10, 2012 confirming that there was no violation. On page 7 of PLR 150025-11, the IRS stated:

> We conclude that the Taxpayer's actions as described above are not inconsistent with the requirements of former § 46(f) of the Code. In accord with the Senate Reports quoted above, the harsh sanctions of disallowance or recapture of the ITC should be imposed, if at all, only after a regulatory body has required or insisted upon such treatment by a utility. Because Commissions A and B did not require or insist on the errors discussed above, no disallowance or recapture is required in this case.

A copy of PLR 150025-11 is attached as Highly Confidential Schedule MKH-6.

Q: In PLR 150025-11, did the IRS address how the amortization of ITC should be treated in future rate proceedings?

A: Yes. The IRS indicated on page 8 of PLR 150025-11, that the letter ruling would be null and void and will have no effect if the Kansas and Missouri public service commissions did not allow the Taxpayer to request a reduction of its amortization of ITC in its next appropriate rate proceeding due to the Taxpayer inadvertently amortizing credits that the Parent Company (GPE) has not used as an offset against federal tax liability on its consolidated tax return.

Q: Did the Company request a reduction of its amortization of ITC in this rate case?

A: Yes. The Company has requested that the amount of amortization for ITC be limited to a ratable portion of the amount of ITC that has been used to offset federal tax liabilities of the GPE consolidated federal tax return.

Q: What does the company believe would happen if the amortization of ITC was not computed on a consolidated basis?

A: Based on the language in PLR 150025-11, the Company believes that the penalties for a violation of the ITC normalization requirement would be imposed. KCP&L would lose the ability use any remaining ITC to offset federal tax liabilities and it would have to repay any remaining unamortized ITC on KCP&L books to the IRS. It would also lose the ability to claim ITC on its federal tax return in future periods until the violation of the normalization requirement is corrected.

Q: If the ITC amortization is reduced in this case, will the ratepayers receive benefit for the amount of ITC that has not been utilized on a consolidated basis in the future?

A: Yes. The GPE consolidated group expects to utilize the remaining ITC in the next four to five years. Once utilized, the Company will amortize a ratable portion of the ITC for ratemaking purposes and the ratepayers will receive the benefit of the remaining ITC at that time.

Q: Are you saying that the ratepayers will not lose any tax benefits of the ITC over time?

A: Yes. The tax benefits related to the amortization of the unutilized ITC on a consolidated basis is not lost to the ratepayers, it is only delayed until such time that they are used.

QUALIFIED ADVANCED COAL PROJECT TAX CREDITS FOR IATAN 2

Q: What is the purpose of this portion of your testimony?

A: I will explain why the Company did not engage in improper conduct or imprudent decision-making with regard to the Qualifying Advanced Coal Project Credits

("Advanced Coal Credits") for Iatan 2 Generating Unit ("Iatan 2"). The technical analysis and consequences of the Staff recommendation to reallocate a portion of Advanced Coal Credits to GMO, or alternative remedies if a reallocation is not feasible, is covered in the Rebuttal Testimony of Company witness Salvatore Montalbano.

Q: What actions has the Staff deemed improper by KCP&L (or Aquila prior to the acquisition of Aquila) with regard to the Advanced Coal Credits?

A: Starting on page 196 of the Staff Cost of Service Report, the Staff has indicated that KCP&L (and Aquila prior to the acquisition of Aquila by GPE) acted imprudently on the six occasions listed below:

1. Aquila should have applied for Advanced Coal Credits with the IRS and Department of Energy in 2007 once it became aware of KCP&L's application.

2. GPE and KCP&L should have included GMO in the resolution of any dispute once it became aware of The Empire District Electric Company's ("Empire") claim to the Advanced Coal Credits in the fall of 2008.

3. Once GPE and KCP&L became aware of the IRS's interpretation that the allocation of Advanced Coal Credits was on a project (or plant) basis versus a taxpayer basis, it should have included Empire and GMO in the allocation of credits.

4. GPE and KCP&L should have included GMO in the arbitration process with Empire in the fall of 2009.

5. After the Empire arbitration decision on December 30, 2009, GPE and KCP&L should have included GMO in the request for reallocation with the IRS.

6. GPE and KCP&L should not have signed the document sent to the IRS with the first request for reallocation of credits to Empire stating that GMO was aware of the request reallocation and that it would not request a separate reallocation in the future.

Q: Do you agree with the Staff assertions that GPE and KCP&L acted imprudently?

A: No, I do not. I will address each of these assertions.

Q: Please explain why each action listed was not imprudent?

A: A brief explanation is listed below for each action:

1. Aquila (name changed to GMO after the acquisition in July of 2008 by GPE) should have applied for Advanced Coal Credits with the IRS and Department of Energy in 2007 once it became aware of KCP&L's application.

- Aquila only became aware of the Advanced Coal Credits a few weeks prior to the deadline to file on October 31, 2007. It would have been extremely difficult to prepare an application in such a short timeframe. Both of KCP&L's applications were several hundred pages in length. In October of 2008, GMO (after the acquisition of Aquila by GPE) did file an application for Advanced Coal Credits which was subsequently denied.
- It is also uncertain if Aquila would have ever been able to utilize advanced coal tax credits to offset federal tax liabilities if it had applied, if its application had been accepted, and if it had been allocated Advanced Coal Credits. At December 31, 2007, Aquila had over $1.2 billion in net operating losses for tax purposes and had a significant valuation allowance against these net operating losses. This indicated that Aquila had no reason to believe that it would generate enough taxable income in future years to use the net operating losses before they expired.

This would also have been the case for any advanced coal tax credits if they had been allocated any credits as well.

- Therefore, Aquila did nothing improper in 2007. Aquila's actions could not have been deemed imprudent given their financial situation at the time and the substantial effort required to apply for credits.

2. GPE and KCP&L should have included GMO in the resolution of any dispute once it became aware of Empire's claim to the Advanced Coal Credits in the fall of 2008.

- In the fall of 2008, GPE and KCP&L believed that each joint owner in Iatan 2 was responsible for its own income tax items, including income tax credits, due to the language provided in the Joint Operating Agreement.
- GPE and KCP&L also believed in 2008 that in order to qualify for the advanced coal tax credit, a taxpayer had to have a minimum of 400 megawatts or more of nameplate capacity for a facility to qualify for the advanced coal tax credits, per the requirements listed in Internal Revenue Code Section 48A(e)(1)(C). Neither Empire nor GMO, as a taxpayer, owned more than 400 megawatts or more of nameplate capacity of Iatan 2.
- Plus, GPE and KCP&L assisted GMO and Empire in preparing a subsequent application for advanced coal tax credits for each owner that was filed in October of 2008.
- Therefore, GPE and KCP&L did not act imprudently in the fall of 2008.

3. Once GPE and KCP&L became aware of the IRS's interpretation that the allocation of Advanced Coal Credits was on a project (or plant) basis versus a taxpayer basis, it should have included Empire and GMO in the allocation of credits.

- In January of 2009, the Company received the IRS's denial of GMO's application for Advanced Coal Credits. The denial simply stated that KCP&L had already been allocated $125 million in Advanced Coal Credits for the facility. This is the first indication that the IRS had interpreted that the maximum of $125 million in credits was on a total plant basis and not on a taxpayer basis. By this time, KCP&L had already entered into a memorandum of understanding ("MOU") with the IRS regarding the allocation of the credits to KCP&L.
- IRS guidance available at the time indicated that a new MOU was possible with the IRS if a facility was sold to another taxpayer. There was no guidance available stating that GPE and KCP&L could ask for a revised MOU with the IRS for any other reason.
- Therefore, in January of 2009, GPE and KCP&L did not have any indication that it could request a reallocation to Empire or to GMO. Failing to seek a reallocation, when the Company had no reason to believe reallocation was possible, was not imprudent.

4. GPE and KCP&L should have included GMO in the arbitration process with Empire in the fall of 2009.

- As indicated before, based on the language provided in the Iatan 2 Joint Operating Agreement, each joint owner in Iatan 2 was responsible for its own income tax items, including income tax credits. In the fall of 2009, there was no reason to believe otherwise.

- At no other time in the Company's history has an income tax item been the responsibility of another joint owner for any of the jointly owned plants it operates or in which it is a minority partner.
- Therefore, GPE and KCP&L did not act imprudently when not including GMO in the arbitration.

5. After the Empire arbitration decision on December 30, 2009, GPE and KCP&L should have included GMO in the request for reallocation with the IRS.

- When KCP&L and Empire requested a reallocation of Advanced Coal Credits in 2010, no one knew if it was even possible under the tax laws to reallocate the tax credits to another taxpayer. KCP&L and GPE believed, based on advice from counsel, that including a taxpayer who was not a party to the arbitration would have made the request for reallocation more difficult for the IRS.
- If the request for reallocation to Empire was unsuccessful, KCP&L would have had to pay Empire for its portion of the Advanced Coal Credits as indicated in the arbitration order. A payment to another taxpayer for ITC credits could have been a "normalization violation," and the penalties associated with a violation may have been imposed. Therefore, it was imperative that KCP&L and GPE take any action to make the request as attractive as possible for the IRS to accept the reallocation to Empire. And, in this case, it meant that GPE and KCP&L did not ask for GMO to be included in the request for reallocation.
- Therefore, GPE and KCP&L did not act imprudently in not including GMO in its request for reallocation.

6. GPE and KCP&L should not have signed the document sent to the IRS with the first request for reallocation of credits to Empire stating that GMO was aware of the request reallocation and that it would not request a separate reallocation in the future.

- As stated in the previous explanation, GPE and KCP&L believed that it was imperative to take any action to make the request as attractive as possible for the IRS to accept the reallocation of advanced coal tax credits to Empire in order to avoid a potential normalization violation and the penalties that could have been imposed on KCP&L.
- As part of the process for the reallocation to Empire, the IRS requested that GMO sign a statement that GMO was aware of KCP&L and Empire's request for reallocation of advanced coal tax credits and GMO would not request another reallocation in the future. KCP&L and GPE felt that if it denied the IRS's request that it would harm its chances of getting a reallocation of credits to Empire. As a result, GMO signed the necessary document.
- And, despite the document signed by GMO, GPE, KCP&L, and GMO did go back and request a reallocation of Advanced Coal Credits to GMO from the IRS when it was ordered to do so by the Commission in Case No. ER-2010-0355.
- Therefore, GMO did not act imprudently when it signed the document stating it would not request a reallocation of Advanced Coal Credits to GMO in the future.

Q: Is there any other Staff testimony that you feel is misleading regarding actions taken by the Company related to the advanced coal tax credits?

A: Yes. On page 198 of Mr. Featherstone's testimony in the Staff's Cost of Service Report, Mr. Featherstone indicates that the Staff compiled notes of a September 21, 2011 telephone call with several members the MPSC Staff, an IRS representative, and several representatives of KCP&L related to the IRS's denial of GMO's request to reallocate Advanced Coal Credits in 2011. The Staff's notes indicate that the Staff asked:

> **[redacted]**

The Company believes that this statement is misleading.

Q: Why does the Company believe that this statement is misleading?

A: The Company agrees that the IRS representative did indicate that the Company could again request the credits to be reallocated from KCP&L to GMO and that it could include GPE and other interested parties (such as the other joint owners, the KCC, etc.) in such application. But, according to notes compiled by the Company related to the call, the IRS representative also indicated that the **[redacted]** The message from the IRS was that – while KCP&L and GMO were certainly free to ask – a reallocation was not likely.

Q: Has the Company requested a reallocation of advanced coal tax credits to GMO a second time?

A: No. The Company believes that the statements made by the IRS representative on September 21, 2011 indicate that the IRS would not be willing to reallocate the credits even if it was requested again, so the Company has not pursued this action.

Q: Does the Staff indicate any other reasons why the Commission should reallocate credits to GMO in this case (or take an alternative action)?

A: The Staff provides three other reasons that the Commission should take the actions Staff proposes for the Advanced Coal Credits.

1. That GMO shared in the cost of building Iatan 2, therefore it should share in any tax benefits generated by Iatan 2.
2. That KCP&L has not fulfilled its obligations to GMO under the Joint Operating Agreement between the two companies.
3. That the Iatan 2 coal credits are a detriment of the Aquila acquisition and that the ratepayers have been harmed.

Q: Do you agree that GMO shared in the cost of building Iatan 2 and should share in any tax benefits?

A: The Company agrees that GMO has shared in the cost of building Iatan 2 and that it should share in any tax benefits related to Iatan 2 if by doing so it does not create additional harm to both entities. KCP&L and GPE are convinced that any action taken to reallocate the credits to the other joint owners without a revised MOU would create a normalization violation. A normalization violation could trigger the recapture of not only the advanced coal tax credits but any other unamortized ITC credits on the books of entities involved in the violation (including both KCP&L and GMO). Therefore, the Company has taken any action it deemed necessary to prevent a normalization violation even if it meant that it did not reallocate credits to GMO. Reallocating tax credits to GMO would cost the ratepayers substantially more than it would benefit them.

Q: How much unamortized ITC is on the books of KCP&L and GMO that is not related to the advanced coal tax credits?

A: At December 31, 2011, KCP&L had $21.4 million of other unamortized ITC and GMO had $3.4 million.

Q: Do you agree with Staff's assertion that KCP&L has not fulfilled its obligations to GMO under the Joint Operating Agreement? Refer specifically to the statement that GPE and KCP&L have violated Section 1.8 of the Joint Operating Agreement between KCP&L and GMO whereby it states "KCP&L will seek to maximize the aggregate synergies to both companies, and shall not take any action that would unduly prefer either party."

A: No. Every action taken by GPE and KCP&L has been to maximize the amount of advanced coal tax credits for all of the affected ratepayers. KCP&L was the only joint owner who pursued the advanced coal tax credits with the IRS and the Department of Energy before to the acquisition of GMO and before the Joint Operating Agreement identified above was signed. After KCP&L received an allocation of credits, the Company was, and as noted above, is still very concerned that any action taken to reallocate the credits to the other joint owners without a revised MOU would create a normalization violation. Therefore, KCP&L and GPE have taken any action deemed necessary to prevent a normalization violation even if it meant that KCP&L did not reallocate credits to GMO. This has preserved the maximum amount of credits for all ratepayers.

Q: Do you agree that the Iatan 2 Advanced Coal Credits are a detriment of the Aquila acquisition and that the ratepayers have been harmed?

A: As discussed in the Rebuttal testimony of Company witness, Darrin R. Ives, Staff's treatment disregards the Commission's decision in the merger Report and Order, in Case No. EM-2007-0374, where the Commission clearly determined that the merger was not detrimental to the public interest. Additionally, the Commission looked at the transaction in total in concluding that there was no detriment to the public interest. Thus acquisition detriments must be looked at in conjunction with synergy savings being unlocked by the merger. Per Mr. Ives Rebuttal testimony, the synergy savings have exceeded any alleged acquisition detriments. Therefore, the ratepayers have not been harmed by the acquisition.

Q: Why does the Company believe that there would be a normalization violation if credits were reallocated to GMO (or any other action that would get the same benefits to GMO ratepayers) without getting an amended MOU from the IRS?

A: If ITC was reallocated to GMO and the benefit flowed through to the ratepayers even though GMO did not claim any ITC under IRC Section 48A (and credits were not reallocated to GMO per a revised MOU with the IRS), more than a ratable amount of ITC would be included in GMO's cost of service. More than a ratable amount of ITC included in GMO's cost of service would constitute a normalization violation. Please see the Rebuttal Testimony provided by Salvatore Montalbano for a detailed technical explanation of this issue.

Q: Could the Company request a private letter ruling from the IRS on whether the actions proposed by Staff to reallocate the Advanced Coal Credits to GMO would be a normalization violation?

A: Yes.

Q: Has the Company already sent a private letter ruling request to the IRS on whether or not the actions proposed by Staff would be a normalization violation?

A: No. The Company has already prepared a private letter ruling request, but it has not been able to send it to the IRS yet. The Company is required to get acknowledgement from the Staffs of both Missouri and Kansas that it has seen the private letter ruling. This is usually accomplished by Staff providing a letter back to the IRS stating that it has seen the request and providing comments whether or not it agrees with the facts and analysis prepared by the Company in the request. The Company sent the first draft of the private letter ruling request to both Staffs on May 9, 2012. The Kansas Staff sent its letter to the Company on May 17, 2012, which included no concerns. The Missouri Staff requested a few changes and the Company incorporated the changes where it felt it was appropriate. The Company sent a final draft of the private letter ruling to the Missouri Staff on June 23, 2012 and the Company has been waiting for the Missouri Staff to provide its acknowledgement in a letter to the IRS. Once the letter from the Missouri Staff is received, the Company will file the private letter ruling request.

Q: What are the proposed actions outlined in the draft private letter ruling request?

A: The first three proposed actions are based on Staff's recommendations regarding the Advanced Coal Credits in Case No. ER-2010-0355:

1. Reallocate Advanced Coal Credits from KCP&L, impute the Advanced Coal

Credits to GMO and then amortize as a reduction to GMO's cost of service for ratemaking purposes and in its regulatory books of account;

2. Order a proportionate reduction in GMO's cost of service in an unrelated cost of service area to pass on the equivalent of the proportionate tax credit benefit to GMO and its customers;

3. Order a reduction to KCP&L's and GMO's return on equity.

In the event all three of the alternatives suggested by the Staff violate the normalization requirements with respect to Advanced Coal Credits, KCP&L and GMO has also included a request for a ruling on whether an interest-free intercompany loan structure between KCP&L and GMO (whereby KCP&L loans an amount equal to the amount of ITC utilized proportional to GMO's ownership in Iatan 2 to GMO and the loan is repaid ratably over KCP&L's book life of the plant) would be in compliance with the normalization requirements applicable to KCP&L and GMO.

Q: If the IRS states in a private letter ruling that any of the proposed actions in the PLR request related to the advanced coal tax credits would <u>NOT</u> be a normalization violation, would the Company take such actions?

A: Yes. If the IRS states in a private letter ruling request that any of the proposed actions related to the Advanced Coal Credits are not a normalization violation, the Company would agree to provide GMO ratepayers with the equivalent amount of tax benefits (or other benefit that the IRS agrees is not a normalization violation) they would have gotten if the IRS had agreed to reallocate the advanced coal tax credit to GMO. Any action should only impact the revenue requirement of KCP&L and GMO by the approximate amount of tax benefits that GMO ratepayers would have received if the IRS had agreed to reallocate Advanced Coal Credits to GMO.

Q: Does that conclude your testimony?

A: Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement A General Rate Increase for Electric Service	)))	Case No. ER-2012-0174

AFFIDAVIT OF MELISSA K. HARDESTY

STATE OF MISSOURI)
) **ss**
COUNTY OF JACKSON)

Melissa K. Hardesty, being first duly sworn on her oath, states:

1. My name is Melissa K. Hardesty. I work in Kansas City, Missouri, and I am employed by Kansas City Power & Light Company as Senior Director of Taxes.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of Kansas City Power & Light Company consisting of thirty (30) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.

Melissa K. Hardesty
Melissa K. Hardesty

Subscribed and sworn before me this 5th day of September, 2012.

Nicole A. Wehry
Notary Public

My commission expires: Feb. 4, 2015

NICOLE A. WEHRY
Notary Public - Notary Seal
State of Missouri
Commissioned for Jackson County
My Commission Expires: February 04, 2015
Commission Number: 11391200

Kansas City Power & Light Company				
Differences between Taxable Income for Ratemaking Models and for KCMO Earnings Tax Return				
Before Consideration of Revenue Requirement Request				
		Ratemaking Models	**Tax Return, incl KCREC**	**Tax Return Taxable Income higher/lower than Ratemaking**
Income				
	Contributions in Aid of Construction	Reduce plant basis	Income	higher
	Gain/Loss on sale of property	Include in Reserve for Depr	Income (generally a loss)	lower
	Non-utility income, excluding interest inc	Exclude	Include	higher
	Fee from KCREC to collect receivables	Include	Include as exp	same
	Excess margins on off-system sales	Defer & amortize over 10 yrs	Include when incurred	higher in year incurred
	Gain on sale of emissions allowances	Defer & amortize over 21 yrs	Include when incurred	higher in year incurred;lower in subsequent years
Deductions				
	Depreciation/amortization including amortization of nuclear fuel	Straight Line Tax basis	Accelerated Depr incl bonus (a)	lower
	Additional Amortization for Credit Ratios	Include	Exclude	higher
	Interest expense	Based on interest synchronization using long term debt rates; excludes interest on short term debt	Actual, including short term interest	higher
	Maintenance expense	Financial test year as normalized	Includes Repair Allowance and Repair Expense	lower
	KCREC income and expenses	Exclude except for bad debts and bank fees	Exclude	lower
	Discount on accounts receivable sold to KCREC (account 826600)	Include as bad debt expense	Include as expense	same
	Non-utility expense, excluding KCREC	Exclude	Include	lower
	Nuclear refueling outage	Costs deferred and amortized	Costs deducted as incurred	depends on year
	Deferral of costs into regulatory assets (DSM, pension tracker, rate case expense)	Costs deferred and amortized	Costs deducted as incurred	lower in year incurred

Differences between Taxable Income for Ratemaking Models and for KCMO Earnings Tax Return				
Before Consideration of Revenue Requirement Request				
		Ratemaking Models	**Tax Return, incl KCREC**	**Tax Return Taxable Income higher/lower than Ratemaking**
	Deferral of costs into regulatory liability (Deferred gain on SO2 allowances, excess margins on OSS)	Cost deferred and amortized	Costs reflected in income as incurred	higher in year incurred
	Amortization of regulatory assets	Include	Exclude	higher, over amort period
	Amortization of regulatory liability	Include	Exclude	lower, over amort period
	Charitable Contributions	Exclude	Include	lower
	Advertising (no adj for Surveillance Report)	Exclude image and institutional	Include all	lower - rate case only
	Deferral of Iatan 1/Common & Iatan 2 costs	Costs over base amount are deferred and amortized	Costs deducted as incurred	lower
	Write off of plant and other disallowances	Exclude	Basis adjustment	same
	Pension costs	Deduct amount expensed	Deduct amount contributed, including amounts capitalized	lower, after adoption of Pension Protection Act
	Software - internal development costs	Amort over 5 or 10 years	Deduct as incurred	lower
	KS ECA adjustment	Exclude	Include ($8.8M deduction in 2010)	lower
	Net Operating Losses		Not recognized	
	a) Impact of bonus depreciation			
	2009 - 50% bonus			
	2010 - 100% bonus for 4 months			
	2011 - 100% bonus for 12 months			
	2012 - 50% bonus			
	2013 - 0% bonus			

Kansas City Power & Light Company
Differences between Taxable Income for Ratemaking Models and for KCMO Earnings Tax Return

Ratemaking - Missouri Jurisdictional
Earnings Tax Return -Total KCPL shown at 53.5%

		2010	2009	2008	2007	2006
Income						
Contributions in Aid of Construction						
Tax Return	Include in income	1,194,178	3,303,375	4,313,690	3,031,691	4,050,857
Ratemaking	Reduce plant basis	0	0	0	0	0
	Taxable income per Return greater (less) than Ratemaking - MO juris	1,194,178	3,303,375	4,313,690	3,031,691	4,050,857
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**7,762**	**21,472**	**28,039**	**19,706**	**26,331**
Gain/Loss on Sale of Property						
Tax Return	Income (generally a loss)	(8,368,646)	(3,043,684)	561,604	(2,138,622)	(5,789,494)
Ratemaking	Include in Reserve for Depr	0	0	0	0	0
	Taxable income per Return greater (less) than Ratemaking - MO juris	(8,368,646)	(3,043,684)	561,604	(2,138,622)	(5,789,494)
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**(54,396)**	**(19,784)**	**3,650**	**(13,901)**	**(37,632)**
Gain on Sales of Emissions Allowances						
Tax Return	Income in year allwances sold for gain		29,118	196,925	12,814,344	438,857
Ratemaking	Defer and amortize to revenues over 21 years beginning June 2011					
	Taxable income per Return greater (less) than Ratemaking - MO juris	0	29,118	196,925	12,814,344	438,857
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**0**	**189**	**1,280**	**83,293**	**2,853**
Excess Margins on Off System Sales (before amortiz over 10 yrs)						
Tax Return	Cost deducted as incurred (100% MO)	3,343,107	(557,199)	2,982,690	1,082,974	n/a
Ratemaking	Cost deferred and amortized over 10 years	408,975	136,325	0	0	n/a
	Taxable income per Return greater (less) than Ratemaking - MO juris	2,934,132	(693,524)	2,982,690	1,082,974	
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**19,072**	**(4,508)**	**19,387**	**7,039**	
Deductions						
Plant Depreciation & Amortization						
Tax Return	Accellerated depreciation including bonus depreciation	(198,621,527)	(141,180,312)	(106,754,283)	(99,311,447)	(81,055,158)
Ratemaking	Tax basis straight line	(115,397,180)	(90,774,144)	(79,473,271)	(78,158,741)	(73,907,082)
	Taxable income per Return greater (less) than Ratemaking - MO juris	(83,224,347)	(50,406,168)	(27,281,012)	(21,152,706)	(7,148,076)
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**(540,958)**	**(327,640)**	**(177,327)**	**(137,493)**	**(46,462)**

Kansas City Power & Light Company
Differences between Taxable Income for Ratemaking Models and for KCMO Earnings Tax Return

Ratemaking - Missouri Jurisdictional
Earnings Tax Return -Total KCPL shown at 53.5%

		2010	2009	2008	2007	2006
Additional Amortization to Maintain Credit Ratios						
Tax Return	None	0	0	0	0	
Ratemaking	Accrued per rate orders - MO juridictional portion	(42,402,888)	(35,736,221)	(32,402,888)	(21,679,061)	n/a
	Taxable income per Return greater (less) than Ratemaking - MO juris	42,402,888	35,736,221	32,402,888	21,679,061	
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**275,619**	**232,285**	**210,619**	**140,914**	
Software Deduction - Internal Development Costs						
Tax Return	Cost deducted as incurred.	(4,520,922)	(6,919,307)	(8,300,835)	(6,717,211)	(3,610,900)
Ratemaking	Cost deferred & amortized over 5 or 10 yr	0	0	0	0	0
	Taxable income per Return greater (less) than Ratemaking - MO juris	(4,520,922)	(6,919,307)	(8,300,835)	(6,717,211)	(3,610,900)
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**(29,386)**	**(44,975)**	**(53,955)**	**(43,662)**	**(23,471)**
Interest Expense						
Tax Return	Actual, including short-term interest expense	(46,132,552)	(37,269,480)	(30,073,007)	(36,864,881)	(32,116,881)
Ratemaking	Based on Interest Synchronization using long-term interest rates	(78,394,102)	(56,399,824)	(40,027,186)	(29,423,913)	(36,207,197)
	Taxable income per Return greater (less) than Ratemaking - MO juris	32,261,550	19,130,344	9,954,179	(7,440,968)	4,090,316
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**209,700**	**124,347**	**64,702**	**(48,366)**	**26,587**
Maintenance Expense - Return M1 For Repair Allow & Repair Expense						
Tax Return	Includes Repair Allowance & Repair Expense	(35,913,269)	(43,805,828)	(21,246,703)	(17,419,940)	(10,110,521)
Ratemaking	Financial test year as adjusted	0	0	0	0	
	Taxable income per Return greater (less) than Ratemaking - MO juris	(35,913,269)	(43,805,828)	(21,246,703)	(17,419,940)	(10,110,521)
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**(233,436)**	**(284,738)**	**(138,104)**	**(113,230)**	**(65,718)**
Wolf Creek Refueling Outage Expense						
Tax Return	Cost deducted as incurred - Show amount incurred	(2,421,630)	(10,995,877)	(9,801,374)	(1,543,446)	(8,149,182)
Ratemaking	Cost deferred and amortized - Show amount amortized	(8,029,097)	(6,510,273)	(6,626,008)	(5,557,043)	(5,138,093)
	Taxable income per Return greater (less) than Ratemaking - MO juris	5,607,467	(4,485,604)	(3,175,366)	4,013,597	(3,011,089)
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**36,449**	**(29,156)**	**(20,640)**	**26,088**	**(19,572)**

Kansas City Power & Light Company
Differences between Taxable Income for Ratemaking Models and for KCMO Earnings Tax Return

Ratemaking - Missouri Jurisdictional
Earnings Tax Return -Total KCPL shown at 53.5%

		2010	2009	2008	2007	2006
Iatan 2 Deferral - Continuation of Construction Acccounting Expense						
Tax Return	Deduct currently (100% MO juris)	(17,196,292)	n/a	n/a	n/a	n/a
Ratemaking	Defer to Plant; amortize over 47.7 years	0	n/a	n/a	n/a	n/a
	Taxable income per Return greater (less) than Ratemaking - MO juris	(17,196,292)				
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**(111,776)**				

Kansas City Power & Light Company
Differences between Taxable Income for Ratemaking Models and for KCMO Earnings Tax Return

Ratemaking - Missouri Jurisdictional
Earnings Tax Return -Total KCPL shown at 53.5%

		2010	2009	2008	2007	2006
Iatan 1/Common Deferral of Carrying Costs/Depreciation						
Tax Return	Deduct currently - Show only 100% MO	(7,659,759)	(3,941,185)	n/a	n/a	n/a
Ratemaking	Defer to Plant; amortize over 26 years	0	0	n/a	n/a	n/a
	Taxable income per Return greater (less) than Ratemaking - MO juris	(7,659,759)	(3,941,185)			
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**(49,788)**	**(25,618)**			
Pension Cost (Tax Return M-1 only)						
Tax Return	Deduct amount contributed, including capital	9,987,654	5,581,592	8,943,350	6,117,223	3,883,451
Ratemaking	Deduct amount expensed					
	Taxable income per Return greater (less) than Ratemaking - MO juris	9,987,654	5,581,592	8,943,350	6,117,223	3,883,451
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**64,920**	**36,280**	**58,132**	**39,762**	**25,242**
DSM Program Costs (Tax Return M-1 only) 100% MO portion						
Tax Return	Cost deducted as incurred. Amount = incurred less amortization	(9,006,624)	(8,654,838)	(6,411,538)	(3,316,679)	(3,566,238)
Ratemaking	Cost deferred & amortized over 10 yr					
	Taxable income per Return greater (less) than Ratemaking - MO juris	(9,006,624)	(8,654,838)	(6,411,538)	(3,316,679)	(3,566,238)
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**(58,543)**	**(56,256)**	**(41,675)**	**(21,558)**	**(23,181)**
Kansas Energy Regulatory Cost Adjustment						
Tax Return	Include	(4,692,000)	1,182,291	(1,614,332)	n/a	n/a
Ratemaking	Exclude	0	0	0	n/a	n/a
	Taxable income per Return greater (less) than Ratemaking - MO juris	(4,692,000)	1,182,291	(1,614,332)		
	Tax expense per Return is greater (less) than Ratemaking @ .65%	**(30,498)**	**7,685**	**(10,493)**		
	Listed Items - Return earnings tax greater (less) than Ratemaking @ .65%	(495,261)	(370,606)	(57,664)	(144,700)	(137,876)

IRS Letter Rulings and TAMs (1954-1997), UIL No. 46.06-02; UIL No. 46.06-06, Letter Ruling 9309013, (Dec. 01, 1992), Internal Revenue Service, (Dec. 1, 1992)

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Letter Ruling 9309013, December 1, 1992

CCH IRS Letter Rulings Report No. 836, 03-10-93

IRS REF: Symbol: CC:P&SI:06-TR-31-67-92

Uniform Issue List Information:

UIL No. 0046.06-02

UIL No. 0046.06-06

[Code Sec. 46R]

This letter responds to your letter of January 9, 1992, requesting rulings under the normalization requirements of section 46(f)(2) of the Internal Revenue Code with respect to a deferred accounting procedure on the proper period for amortizing investment credit.

Taxpayer represents that the facts are as follows:

Taxpayer is an investor-owned public utility engaged in the generation, purchase, transmission, distribution, and sale of electricity in State X, and is regulated by the Commission. Taxpayer is a wholly owned subsidiary of Parent, which files a consolidated federal income tax return on a calendar year basis using the accrual method of accounting.

For purposes of the investment credit normalization rules under section 46(f) of the Code, Taxpayer has elected to be treated under section 46(f)(2).

In its request for rate increases in Docket Y, Taxpayer based its revenue requirements on a historical test year ended ***** and made a post test year adjustment by ***** reclassifying its investment in the Plant from Construction Work in Progress to Plant in Service. This investment includes Taxpayer's purchase of minority ownership interests in the Plant ("Purchased Assets").

In its final order in Docket Y, however, the Commission disallowed X dollars of Taxpayer's investment in the Plant as imprudent expenses for ratemaking purposes and consequently, the X dollars are excluded from both rate base and regulated book depreciation. This ruling request pertains only to the portion of Taxpayer's investment in the Plant that is included in rate base and regulated book depreciation.

Taxpayer represents that the Plant, including the Purchased Assets, was placed in service for Federal income tax purposes on ***** Taxpayer further represents that the Purchased Assets qualify as transition property under sections 49(b) and (e) of the Code. The amount of investment credit generated in ***** on the Purchased Assets is y dollars.

The rates established in Docket Y reflect depreciation of the Plant, including the Purchased Assets, using a depreciable life of ***** years. The rates, however, do not reflect the amortization of investment credit attributable to the Purchased Assets.

Because the rates do not reflect the amortization of investment credit related to the Purchased Assets, the Commission in its final order in Docket Y adopted its Staff's recommendation regarding a deferred accounting procedure. Specifically, the Staff recommended the following accounting procedure:

(1) Credit Account 255.4001, Accumulated Deferred ITC--Utilized, for the investment credit attributable to the Purchased Assets;

(2) Debit Account 255.4002, Accumulated Deferred ITC--Amortization, for the monthly amortization of the investment credit in Account 255.4001 (monthly amortization calculated as y dollars, ***** years/12 months); and

(3) Credit Account 253, Other Deferred Credits, for amount in (2) above for months beginning with the month that rates established in Docket Y are effective until these rates are changed in Taxpayer's next rate case.

Under the Staff's deferred accounting procedure, the cumulative amortization recorded in Account 253 will be used as an immediate reduction to Federal income tax expense in Taxpayer's next rate case (the "catch-up provision"), which should be in *****. This procedure is based on the assumption that Taxpayer would utilize the investment credit of y dollars attributable to the Purchased Assets in ***** or before Taxpayer's next rate case. However, Taxpayer was unable to use this investment credit either in ***** or in the carryback years because of the investment credit limitation rules of section

Schedule MKH-5

38(c)(1) of the Code. Taxpayer anticipates that the investment credit of y dollars will be carried forward to more than one tax year.

Because the Commission's Staff recognized that its deferred accounting procedure may violate the normalization requirements of section 46(f)(2) of the Code, the Commission in its final order in Docket Y ordered Taxpayer to request a letter ruling from the Internal Revenue Service to determine whether the normalization rules under section 46(f)(2) would be violated if the next rate case includes accelerated amortization of the investment credit attributable to the Purchased Assets. Accordingly, Taxpayer seeks the following rulings:

1. Whether the catch-up provision associated with the Staff's deferred accounting procedure for the investment credit attributable to the Purchased Assets would violate the normalization requirements of section 46(f)(2) of the Code if rates are not adjusted after one year to remove the effect of the catch-up provision?

2. Whether the catch-up provision associated with the Staff's deferred accounting procedure for the investment credit related to the Purchased Assets would violate the normalization rules of section 46(f)(2) of the Code if rates are adjusted after one year to remove the effect of the catch-up provision?

3. Whether the straight-line amortization of the deferred amount of the investment credit on the Purchased Assets over the remaining life at the end of the deferral period would violate the normalization provisions of section 46(f)(2) of the Code?

4. Whether the normalization requirements of section 46(f)(2) of the Code would be violated if any portion of the investment credit that is carried forward is amortized in a period before such portion of the investment credit is actually used as an offset against Federal income tax?

5. Whether the normalization rules of section 46(f)(2) of the Code would be violated if the investment credit is amortized over the remaining regulatory life of the asset as of the time the investment credit is utilized for Federal income tax purposes?

Taxpayer has elected to account for its investment credit on public utility property in accordance with section 46(f)(2) of the Code. This section provides that no investment credit shall be allowed with respect to any public utility property of the taxpayer (a) if the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by more than a ratable portion of the investment credit, or (b) if the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the investment credit.

Section 1.46-6(a)(3) of the Income Tax Regulations provides that the provisions of section 46(f)(2) of the Code are limitations on the treatment of the investment credit for ratemaking purposes and for purposes of the taxpayer's regulated books of account only. If an election is made under section 46(f)(2), the credit may be flowed through to income, but not more rapidly than ratably, and there may not be any reduction in rate base.

For purposes of determining whether or not the taxpayer's cost of service for ratemaking purposes is reduced by more than a ratable portion of the investment credit, section 46(f)(6) of the Code provides that the period of time used in computing ***** depreciation expense for purposes of reflecting operating results in the taxpayer's regulated books of account shall be used.

Section 1.46-6(g) of the regulations provides further guidance for determining whether or not, under section 46(f)(2) of the Code, the taxpayer's cost of service for ratemaking purposes is reduced by more than a ratable portion of the investment credit.

According to section 1.46-6(g)(2) of the regulations, what is "ratable" is determined by considering the period of time actually used in computing the taxpayer's regulated depreciation expense for the property for which a credit is allowed. The term "regulated depreciation expense" means the depreciation expense for the property used by a regulatory body for purposes of establishing the taxpayer's cost of service for ratemaking purposes. The period of time shall be expressed in units of years or shorter periods, units of production, or machine hours and shall be determined in accordance with the individual useful life system or composite account system actually used in computing the taxpayer's regulated depreciation expense.

Any public utility that claims the investment credit for public utility property must use "normalization" accounting in calculating the rates to be charged its customers and in maintaining its regulated books of account. Under normalization accounting, the immediate flow-through of the investment credit for public utility property to the utility's customers is prohibited. Instead, under section 46(f)(2) of the Code, the utility defers the investment credits it claims for Federal income tax purposes and then amortizes the deferred balance ratably over the regulatory life of the assets generating the credits. Consequently, the normalization requirements of section 46(f)(2) provide for the sharing of the benefits of investment credit on public utility property between the utility's investors and customers.

Requests 1 and 2

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The first two ruling requests involve the catch-up provision associated with the Staff's deferred accounting procedure. Under this procedure, the catch-up provision will be treated as an immediate reduction to Federal income tax expense in Taxpayer's next rate case. Under both requests, the catch-up provision will be implemented in its entirety in the same year. However, under request 1 the rates will not be adjusted after one year to remove the effect of the catch-up provision, while under request 2 a rate adjustment will be made. Examples of the effect of the catch-up provision under requests 1 and 2, as laid out in the ruling request, follow.

These examples are based on the following factors:

Regulatory life - 39.5 years

Docket Y rates implemented - Year 1

New rates implementing the catch-up provision - Year 4

Under request 1, the schedule of investment credit ***** amortization used to reduce cost of service when an utility does not implement new rates in year 5 to remove the effect of the catch-up provision that is implemented in year 4 is as follows:

Reduction to Tax Expense

Year ITC Amort. Deprec.

1 0/39.5 1/39.5

2 0/39.5 1/39.5

3 0/39.5 1/39.5

4 (new rates) 4/39.5 1/39.5

Subtotal 4/39.5 4/39.5

5 4/39.5 1/39.5

6 4/39.5 1/39.5

7 4/39.5 1/39.5

Total 16/39.5 7/39.5

Under request 2, the schedule of investment credit ***** amortization used to reduce cost of service when rates in year 5 are adjusted to remove the effect of the catch-up provision that is implemented in year 4 is as follows:

Reduction to Tax Expense

Year ITC Amort. Deprec.

1 0/39.5 1/39.5

2 0/39.5 1/39.5

3 0/39.5 1/39.5

4 (new rates) 4/39.5 1/39.5

Subtotal 4/39.5 4/39.5

5 (new rates) 1/39.5 1/39.5

6 1/39.5 1/39.5

7 1/39.5 1/39.5

Total 7/39.5 7/39.5

According to section 46(f)(2) of the Code, a utility's cost of service may not be reduced by more than a ratable portion of its investment credit. Section 1.46-6(a)(3) of the regulations provides that if an election is made under section 46(f)(2), the investment credit may be flowed through to income, but not more rapidly than ratably. In determining what is ratable, section 1.46-6 (g)(2) provides that one considers the period of time actually used in computing the taxpayer's regulated depreciation expense for the property for which a credit is allowed.

The catch-up provision under request 1 violates section 46(f)(2) of the Code because the investment credit is amortized more rapidly than ratably. As illustrated in the above example for request 1, at the end of year 5, 6, or 7, the investment credit related to the Purchased Assets will reduce cost of service faster than the depreciation is taken for such assets on Taxpayer's books. Thus, the "no more than ratable" requirement of section 46(f)(2) is not satisfied.

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However, the catch-up provision under request 2 does not violate section 46(f)(2) of the Code. The method under this request provides for the amortization of the investment credit over the original regulatory life of the Purchased Assets. Further, as shown in the above example for request 2, at no time will the cumulative amount of the investment credit reduce cost of service more rapidly than ratably. Therefore, the method under request 2 satisfies section 46(f)(2).

Request 3

Although the Commission's Staff recommended the catch-up provision, the Staff also realized that the normalization requirements of section 46(f)(2) of the Code may require a ratable amortization of the investment credit over the remaining life of the Plant. Accordingly, the third ruling request involves the proper method of amortizing the investment credit under section 46(f)(2) when the remaining regulatory life of the asset is used.

Under this method, the investment credit attributable to the Purchased Assets will be amortized over the remaining life of the Plant, which includes the Purchased Assets, at the time new rates are implemented. An example of this remaining life method, as laid out in the ruling request, follows.

The example is based on the following factors:

Regulatory life - 39.5 years

Docket Y rates implemented - Year 1

New rates implemented - Year 4

Remaining life at Year 4 - 36.5 years

Under request 3, the schedule of investment credit amortization used to reduce cost of service when using a remaining life method is as follows:

Reduction to Tax Expense

Year ITC Amort. Deprec.

1 0/39.5 1/39.5

2 0/39.5 1/39.5

3 0/39.5 1/39.5

4 (new rates) 1/36.5 1/39.5

5 1/36.5 1/39.5

6-40 1/36.5 1/39.5

The remaining life method under request 3 complies with the normalization requirements of section 46(f)(2) of the Code. Under the method in request 3, the period of time over which the investment credit is amortized is tied to Taxpayer's individual useful life system or composite account system actually used in computing Taxpayer's regulated depreciation expense for the Purchased Assets. Further, at no time will the cumulative amount of the investment credit be flowed through more rapidly than ratably. Thus, the method under request 3 satisfies section 46(f)(2).

Requests 4 and 5

Ruling requests 4 and 5 concern the flow through of an investment credit carryover to cost of service under section 46(f)(2) of the Code. In the present situation, Taxpayer was unable to utilize the investment credit of y dollars in the tax year in which the Purchased Assets were placed in service, and Taxpayer anticipates that the credit will be carried forward to more than one tax year. Thus, request 4 involves the proper period to begin flowing through the investment credit carryover for ratemaking purposes, and request 5 concerns whether the credit carryover may be amortized over the remaining regulatory life of the Purchased Assets at the time the credit is allowed.

Section 46(f)(2) of the Code requires that the reduction in cost of service must be ratable, which is determined under section 1.46-6(g)(2) of the regulations by considering the period of time actually used in computing the taxpayer's regulated depreciation expense for the property for which a credit is allowed. A credit is allowed when it is used as an offset against Federal income tax. Consequently, the normalization rules contemplate that the investment credit will be flowed through ratably to the ratepayers beginning at the time when the credit is used as an offset against Federal income tax. Thus, the normalization rules under section 46(f)(2) would be violated if the investment credit reduces cost of service in a period before the credit is used as an offset against Federal income tax.

When the investment credit is allowed, the amortization of such credit to reduce cost of service must be tied to the taxpayer's individual useful life system or composite account system actually used in computing the taxpayer's regulated depreciation expense. Thus, the straight-line amortization of the investment credit over the remaining regulatory life of

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the related assets at the time the credit is allowed will satisfy the normalization requirements of section 46(f)(2) of the Code. Under this method, the investment credit is flowed through ratably and at no time will the cumulative amount of the credit be flowed through more rapidly than ratably. For example, if one-half of the investment credit carryover of y dollars is allowed in Year 2, then this one-half is amortized over the remaining regulatory life of the Plant at Year 2. (However, if new rates are not implemented in Year 2 but are implemented in Year 4, then the one-half is amortized over the remaining regulatory life of the Plant at the time the new rates are implemented in Year 4. See discussion under request 3 above.) The remaining one-half of the investment credit carryover will be amortized over the remaining regulatory life of the Plant at the time this one-half is allowed.

Based on Taxpayer's representations and the analysis as set forth above, we conclude as follows:

1. The catch-up provision associated with the Staff's deferred accounting procedure for the investment credit related to the Purchased Assets would violate the normalization rules of section 46(f)(2) of the Code if rates are not adjusted after one year to remove the effect of the catch-up provision.

2. The catch-up provision associated with the Staff's deferred accounting procedure for the investment credit attributable to the Purchased Assets would not violate the normalization requirements of section 46(f)(2) of the Code if rates are adjusted after one year to remove the effect of the catch-up provision.

3. The straight-line amortization of the deferred amount of the investment credit on the Purchased Assets over the remaining regulatory life at the end of the deferral period would not violate the normalization provisions of section 46(f)(2) of the Code.

4. If any portion of the investment credit that is carried forward is amortized in a period before such portion of the credit is actually used as an offset against Federal income tax, the normalization requirements of section 46(f)(2) of the Code would be violated.

5. The straight-line amortization of the investment credit over the remaining regulatory life of the asset at the time the credit is utilized for Federal income tax purposes would not violate the normalization rules of section 46(f)(2) of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney, a copy of this letter is being sent to your authorized representatives.

Sincerely yours, Charles B. Ramsey, Chief, Branch 6, Office of Assistant Chief Counsel (Passthroughs and Special Industries)

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