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Witness: Melissa K. Hardesty
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Sponsoring Party: Kansas City Power & Light Company
Case No.: ER-2010-0355
Date Testimony Prepared: December 8, 2010

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2010-0355

REBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

**Kansas City, Missouri
December 2010**

KCPL Exhibit No. **KCPL30**
Date **2/14/11** Reporter **LMB**
File No. **ER-2010-0355**

REBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

Case No. ER-2010-0355

1 **Q: Please state your name and business address.**

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

4 **Q: By whom and in what capacity are you employed?**

5 A: I am employed by Kansas City Power & Light Company ("KCP&L" or the "Company")
6 as Senior Director of Taxes.

7 **Q: What are your responsibilities?**

8 A: My responsibilities include management of KCP&L's taxes, including income, property,
9 sales and use, and transactional taxes.

10 **Q: Please describe your education, experience and employment history.**

11 A: I graduated from the University of Kansas in 1996 with a Bachelor of Science in
12 Accounting. I am a Certified Public Accountant with a permit to practice in the State of
13 Kansas. After completion of my degree, I worked at the public accounting firm Marks,
14 Stallings & Campbell, P.A. as a staff accountant from 1996 to 1999. In 1999, I went to
15 work for Sprint Corporation as a Tax Specialist in the company's federal income tax
16 department. I held various positions from 1999 to 2006. When I left Sprint to join
17 KCP&L in December 2006, I was Manager of Income Taxes for Sprint's Wireless
18 Division. I joined KCP&L as the Director of Taxes and was subsequently promoted to
19 my current position of Senior Director of Taxes for KCP&L in May of 2009.

1 **Q: Have you previously testified in a proceeding at the Missouri Public Service**
2 **Commission (“MPSC” or the “Commission”) or before any other utility regulatory**
3 **agency?**

4 **A:** Yes. I provided testimony in Case Nos. ER-2007-0291, ER-2009-0089 and ER-2009-
5 0090 for KCP&L and KCP&L Greater Missouri Operations Company (“GMO”).

6 **Q: What is the purpose of your testimony?**

7 **A:** The purpose of my testimony is to rebut testimony provided by Staff’s Expert Witnesses
8 Karen Lyons concerning property and gross receipts taxes, Paul Harrison concerning
9 advanced coal credits and other ITC, Kansas City earnings taxes and excess deferred
10 income taxes, and Keith Majors concerning consulting fees incurred related to the
11 advanced coal credit arbitration.

12 **Property Taxes**

13 **Q: Please address your concerns regarding Ms. Lyons’ property tax testimony.**

14 **A:** Ms. Lyons’ direct testimony indicates that the case will be tried up to utilize actual 2010
15 property tax cost billed as of December 31, 2010 since that is the known and measurable
16 cost. However, Ms. Lyons does not address whether this includes the property taxes
17 capitalized during the construction of Iatan Unit 2. In addition, a different method was
18 used to calculate the property tax expense included by Ms. Lyons in Staff’s Cost of
19 Service schedule. The method used is an annualized level of 2010 property taxes. In her
20 testimony, Ms. Lyons states that the annualized 2010 property tax expense was calculated
21 by multiplying January 1, 2010 plant-in-service balance by the ratio of January 1, 2009
22 plant-in-service balance to the taxes paid in 2009.

1 Q: Are you in agreement with the method Ms. Lyons used to calculate annualized 2010
2 property tax expense?

3 A: No. I do not agree with the calculations prepared by Ms. Lyons. Ms. Lyons stated in her
4 testimony that the 2009 property taxes paid should be divided by the January 1, 2009
5 plant-in-service balances to determine the ratio to be applied to the January 2010 plant-
6 in-service balance to calculate the 2010 property tax expense. The formula used on Ms.
7 Lyons' supporting schedule for property taxes divided the 2009 property tax expense by
8 the January 1, 2010 plant-in-service balance to calculate the ratio. I believe this is a
9 computational error on Ms. Lyons' part. Additionally, the 2009 property tax expense
10 number used in the calculation included the \$347,820 pilot for the Spearville wind farm.
11 I believe that this amount should be excluded from the 2009 property tax as a percentage
12 of cost calculation, since it is not based on the value of KCP&L's plant and is negotiated
13 separately with the relevant parties. Staff's calculation also failed to include unit train
14 property taxes.

15 The calculation of the ratio to be applied to the January 1, 2010 plant-in-service balance
16 should have been as follows:

17	2009 Property Taxes (including pilot)	\$58,655,315
18	Less 2009 Spearville Unit 1 Pilot	347,820
19	Add 2009 Unit Trains Property Tax	<u>248,227</u>
20	Total Adjusted Property taxes	\$58,555,722
21		
22	1/1/2009 Plant-in-Service	\$5,633,953,538

23 $58,555,722 / 5,633,953,538 = 1.0393\%$

1 The calculation used in Ms. Lyons' work papers is:

2	2009 Property Taxes (including pilot)	\$58,655,315
3	01/01/2010 Plant-in-Service	\$6,221,168,368
4	$58,655,315/6,221,168,368 = .9428\%$	

5 The result of Ms. Lyons computational error artificially lowers the amount of property
6 tax expense included in the cost of service schedules as prepared by the Staff.

7 In her written testimony, Ms Lyons indicates Staff then used the percentage calculated
8 above to annualize the 2010 property taxes by multiplying this percentage by the plant-
9 in-service as of January 1, 2010. However in her supporting schedules, Ms. Lyons
10 multiplied the plant in-service balances as of September 30, 2010 by the percentage
11 calculated above instead of using the plant-in-service as of January 1, 2010.

12 If the correct percentage of property taxes paid over the plant-in-service balance for
13 January 1, 2009 is applied to the September 30, 2010 plan-in-service balance, the
14 annualized 2010 property taxes would be calculated as follows:

15	Plant in Service September 30, 2010	\$ 7,339,423,448
16	2009 Property Tax divided by 1/1/09 Plant-in-Service	<u>1.0393%</u>
17	Annualized 2010 Property taxes	76,278,628
18	Add: Spearville Unit 1 Pilot	357,497
19	Add: Spearville Unit 2 Pilot	<u>396,610</u>
20	Annualized 2010 Property Taxes and Pilot	<u>\$ 77,032,735</u>

21 If this is the method and the amount Staff intended to use in this case, the Company
22 would be in agreement with this approach.

23 **Q: If instead, both parties utilize 2010 actual property taxes cost incurred, will there**
24 **then be any property tax expense difference between the parties at true-up?**

25 A: There is likely to be one difference. Ms. Lyons did not include in her testimony any
26 reference about the inclusion of 2010 property taxes actually incurred and billed in 2010

1 related to the Iatan Unit 2 construction work in progress. These property taxes were
2 capitalized to Iatan construction work orders during 2010.

3 **Q: Since the capitalized 2010 Iatan generation facility property tax cost was not a 2010**
4 **O&M expense why should this cost be included in property tax expense in this rate**
5 **proceeding?**

6 A: Beginning with the in-service date of Iatan Unit 2 in September 2010, the associated
7 property taxes previously capitalized will be or has been classified as O&M property tax
8 expense. These property taxes are a known and measurable expense that will occur after
9 the assets related to Iatan Unit 2 are placed-in-service. It is reasonable to expect that the
10 O&M property tax impact for these units will be significantly greater than the capitalized
11 property tax during 2009 at issue in this case. This is true because the capitalized
12 property taxes for 2009 were based on January 1, 2009 CWIP balances for Iatan Unit 2.
13 The property taxes associated with the final costs will be much higher because the final
14 costs for the assets placed-in-service during 2010 is higher. The total plant in-service
15 cost for KCPL increased from \$5,633,953,538 on January 1, 2010 to \$7,339,423,448 on
16 September 30, 2010. It is for this reason that the Company considers the inclusion of the
17 2010 Iatan Unit 2 previously capitalized property taxes as a component of property tax
18 expense in this case to be appropriate.

19 **Q: Does including the 2009 Iatan Unit 2 property tax cost result in a “double recovery”**
20 **by “earning a return of and on” the same item?**

21 A: No. It is correct that taxes capitalized prior to the assets being placed in service will be
22 included in the rate base on which KCP&L will earn a return in this rate case. This is
23 always the case for capitalized property taxes. However, it is also correct that KCP&L

1 will incur property taxes as O&M expenses after the assets are placed in service. This
2 annual cost should not be treated differently than any other cost of operating the plant
3 once the assets are placed-in-service.

4 **Gross Receipts Taxes**

5 **Q: Please address your concerns regarding Ms. Lyons' gross receipts tax testimony.**

6 A: Ms. Lyons states that it is her opinion that the 6% Kansas City, Missouri ("Kansas City"
7 or "City") gross receipts tax that is remitted quarterly to the city is not a prepaid tax. This
8 position is not supported by the language of the City ordinance.

9 **Q: Can you explain why the Kansas City ordinance supports the position that the
10 Company's quarterly gross receipts tax payments are a prepayment?**

11 A: Yes, the following excerpt was taken from the Kansas City tax ordinance Sec 40-344:

12 (b) Reports by licensee. The licensee shall and he is hereby required to make true
13 and faithful reports under oath to the director of finance and to the commissioner
14 of revenue of the city, in such form as may be prescribed by the director of
15 finance, and containing such information as may be necessary to determine the
16 amounts to which the license tax shall apply on or before January 30, April 30,
17 July 30, and October 30 of each year, for all gross receipts for the three calendar
18 months ending, respectively on December 31, March 31, June 30 and September
19 30.

20 (c) Payments of license fee. **Each fee shall constitute payment for the three**
21 **months beginning on January 1, April 1, July 1, and October 1, respectively,**
22 **during which months such payment shall be due and payable** as prescribed in
23 this section: provided however that the acceptance of such fee shall not prejudice
24 the right of the city to collect any additional fee thereafter found to be due.
25 (emphasis added)

26 **Q: Why did you emphasize the language in the city ordinance above in part (c)
27 Payment of license fee?**

28 A: This section of the ordinance clearly indicates that a fee paid for a license for any given
29 quarter would be made for the quarter that contained the payment month. Thus a
30 payment on the 30th of January would be for the license for the period of January 1

1 through March 31 and would be considered a prepayment even though the measurement
2 period is the prior quarter.

3 **Q: Has the Kansas City quarterly gross receipts tax always been a prepaid tax?**

4 A: Yes. Prior to January 1, 1943, the tax was prepaid annually based on the number of
5 meters. Starting on January 1, 1943, the City converted from the prepaid meter tax to a
6 prepaid gross receipts tax based on a franchise fee.

7 **Q: Do you agree with Ms. Lyons' assertion that the Company pays the tax to the taxing
8 authorities after it collects them from the customer?**

9 A: No. While the customer pays for the tax at the same time he pays for the electric service,
10 the billing for the gross receipt tax is in fact a recovery of the taxes that the Company pre-
11 paid to the taxing authority.

12 **Q: If KCP&L had sold or ceased operation within the city limits of Kansas City on
13 December 31, 2009, when would the final gross receipts tax payment be made?**

14 A: Based on the language contained in paragraph (c) of the Kansas City tax
15 Ordinance, if KCP&L were to stop serving customers in Kansas City on December 31,
16 2009 the last 6% gross receipts tax license payment would have been made on October
17 30, 2009. Since the October 30, 2009 payment is for the period October 1, 2009 through
18 December 31, 2009, and the company had stopped service to customers in Kansas City,
19 then KCP&L would not be required to have a quarterly license for 2010.

20 **Q: Do you agree with Ms. Lyons' position that all the ordinances for each city in which
21 KCP&L operates have similar language?**

1 A: Yes. I agree that the language in most of the city ordinances in cities where KCP&L
2 operates is similar to the language in the Kansas City ordinance. It is KCP&L's position
3 that the Company's payment of these gross receipts taxes is also a prepayment.

4 **Q: Given your conclusion that these tax payments are prepayments, please discuss the**
5 **Company's recommended regulatory treatment?**

6 A: The Kansas City, Missouri ordinance makes it clear that payments are due not later than
7 the 30th day of the first month of each quarter for the estimated gross receipts tax due.
8 Therefore, these payments are prepayments, not payments in arrears as suggested by
9 Staff.

10 **Advanced Coal Credits and Other ITC**

11 **Q: Please describe the Advanced Coal Credits issue.**

12 A: Mr. Harrison has reduced the amount of advanced coal credit allocated to KCP&L by
13 \$26.5 million. Mr. Harrison believes this amount of advanced coal investment tax credits
14 should be allocated to GMO and benefit GMO ratepayers.

15 **Q: Do you agree with Mr. Harrison's adjustment to the tax credits?**

16 A: No. I do not.

17 **Q: Briefly describe what the advanced coal credit is?**

18 A: An advanced coal credit is an investment tax credit ("ITC") allocated to qualifying
19 advanced coal projects by the Internal Revenue Service ("IRS"). KCP&L was initially
20 allocated \$125 million of advanced coal ITC for its qualified investment in Iatan Unit 2
21 in 2008. The amount of the advanced coal ITC was later reduced to \$107.3 million when
22 arbitration proceedings, with certain joint owners, other than GMO, were finalized in
23 September 2010.

1 **Q: Why has Mr. Harrison proposed an adjustment to reduce the amount of coal credit**
2 **allocated to KCP&L by \$25.6 million?**

3 A: The Empire District Electric Company, Kansas Electric Power Cooperative, Inc., and
4 Missouri Joint Municipal Electric Utility Commission, certain joint owners of Iatan Unit
5 2, filed a notice to arbitrate in 2009, asserting that they were entitled to receive
6 proportionate shares (or the monetary equivalent) of the \$125 million of advanced coal
7 ITC allocated to KCP&L. The arbitrators determined that Kansas Electric Power
8 Cooperative and Missouri Joint Municipal Electric Utility Commission were not entitled
9 to a share of the ITCs, but \$17.7 million of advanced coal ITC was allocated to The
10 Empire District Electric Company by the arbitrators. Mr. Harrison believes that since
11 GMO owns 18% of Iatan Unit 2, it should also be allocated its proportionate share of the
12 advanced coal ITC.

13 **Q: Why does the Company believe that GMO should not be allocated any of the credit?**

14 A: The Company believes that it would be a violation of the Internal Revenue Service
15 normalization rules under Internal Revenue Code Section 46(f) to allocate advanced coal
16 ITC directly or indirectly and an entity that did not claim the credit on its tax return.

17 **Q: What is a normalization violation and why does the Company believe that an**
18 **allocation of advanced coal credits to GMO would be considered a violation?**

19 A: The advanced coal ITC at issue is really a credit defined under Internal Revenue Code
20 Section 48A, Qualifying Advanced Coal Project Investment Tax Credits (ITC). These
21 ITC credits are subject to the normalization rules set forth in IRC Section 46(f). IRC
22 Section 46(f)(2)(A) states that if the taxpayer's cost of service for ratemaking purposes or
23 its regulated books of account is reduced by more than a ratable portion of the credit, then

1 no credit is allowed. This is considered a normalization violation. Since GMO has not
2 been awarded any Section 48A credits, (or been reallocated credits by the IRS in the
3 arbitration proceedings), it is not allowed to include any Section 48A credit to reduce
4 income tax expense for ratemaking purposes.

5 In addition, Regulation 1.46-6(b)(4) also states that the indirect reductions to cost of
6 service of a taxpayer are also considered a violation. This includes any ratemaking
7 decision intended to achieve an effect similar to a direct reduction to cost of service.

8 Several private letter rulings have interpreted the restrictions against indirect reductions
9 of cost of service related to ITC and have held that various ratemaking proposals would
10 violate the normalization requirements. Most recently, PLR 200945006 addressed the
11 sale of regulated gas distribution assets from one utility to another. At issue was whether
12 the accumulated deferred ITC of the selling utility could be transferred to the buying
13 utility to ultimately be used to reduce the rates of the buying utility. The IRS National
14 Office held that the selling utility would violate the requirements of the investment tax
15 credit normalization rules set forth in former section 46(f), if it directly or indirectly
16 passes the accumulated deferred ITC balance to another taxpayer who did not claim such
17 ITC tax benefits. Therefore any direct or indirect allocation of credits to GMO from
18 KCP&L would also be normalization violation under IRS regulations.

19 **Q: What is the penalty for a normalization violation?**

20 Per the Tax Reform Act of 1986 Section 211(b), the penalty for a violation of the ITC
21 normalization requirements is the recapture/repayment to the IRS the greater of ITC
22 claimed in all open tax years as of the date of the violation or the amount of ITC tax
23 credit remaining on the taxpayers' books of account. This would include all advanced

1 coal credit ITC used to offset the Company's tax liability for open periods and all
2 accumulated deferred ITC remaining on KCP&L for any other previous qualifying
3 investment tax credit properties. Therefore, if KCP&L allocated benefits of advanced
4 coal ITC credits in violation of the normalization rules, KCP&L would have to repay the
5 IRS for all outstanding ITC remaining on its books for previous investment tax credit
6 properties, pay the IRS for the advanced coal credits used to offset Company tax
7 liabilities, and it would not be able to use any unused credits to offset future tax
8 liabilities.

9 **Q: What is the amount of ITC that would have to be repaid to the IRS by KCP&L for**
10 **a normalization violation?**

11 At September 30, 2010, the advanced coal ITC credit already used to offset Company tax
12 liabilities is \$29,151,153, and the remaining ITC on KCP&L books for other previous
13 ITC projects is \$23,143,258. Therefore, the Company would have to repay the IRS
14 \$52,294,411. In addition, \$77,957,534 of advanced coal ITC would not be available to
15 offset future tax liabilities. The total penalty to KCP&L for a normalization violation is
16 \$130,251,945.

17 **Q: Can the Company get guidance from the IRS regarding a potential normalization**
18 **violation?**

19 **A:** Yes. The Company may request a ruling from the IRS as to whether or not the allocation
20 of the credits to GMO is, in fact, a normalization violation. The Company feels strongly
21 that any allocation of the advanced coal credits to GMO would be a normalization
22 violation. However, if the Commission believes that it is appropriate to allocate credits to
23 GMO, KCP&L requests the opportunity to request a ruling from the IRS before any

1 decision is made final and the harm that may be incurred to the Company and the
2 ratepayers cannot be reversed.

3 **Q: Are there any other issues related to the advanced coal credits or other ITC in this**
4 **case?**

5 A: Yes. The amortization of the advanced coal credits cannot be more than a ratable portion
6 of the credit over the life used for book purposes to depreciation Iatan Unit 2. The life
7 used for the amortization of the advanced coal credit by the Company and Staff is
8 currently 50 years in the case. This life is consistent with the depreciable book life as
9 suggested by the Company. However, Staff has requested a longer depreciable book life
10 for Iatan Unit 2. If the depreciable book life of Iatan 2 is ultimately something other than
11 50 years, then the life used for the amortization of the advanced coal ITC must also be
12 changed to agree. This is also true for the other ITC included in the case. If the
13 depreciable book life is changed for other assets that generated ITC in prior years, then
14 the amount of other ITC included in the case must also be recomputed.

15 **Q: What happens if the life used for amortization of advanced coal ITC or other ITC**
16 **does not agree with the amortization period used for the depreciable book life of**
17 **Iatan Unit 2 or the other assets that generated the ITC?**

18 A: If the life used for the amortization advanced coal ITC or other ITC does not agree with
19 the depreciable book life for the assets they relate to, then a normalization violation has
20 occurred and the penalty is the same as the penalty for allocating a portion of the ITC to
21 GMO mentioned previously.

22 **Q: Please summarize your position on the issues associated with the advanced coal ITC**
23 **credit?**

1 A: The Company believes that it cannot allocate advanced coal ITC to GMO or have a
2 different amortization period for the advanced coal ITC from the book depreciable life
3 for Iatan Unit 2 without incurring significant penalties by the IRS and harming the
4 Company and the ratepayers. Therefore, the Company is requesting that no advanced
5 coal ITC be allocated to GMO and that the amortization period for the advanced coal ITC
6 agree with the depreciable book life ultimately determined for Iatan Unit 2 in this case.
7 The Company also requests that the other ITC included in this case also be recomputed if
8 the depreciable book life is changed for the assets associated with the other ITC. In the
9 event the Commission believes that it may be appropriate to allocate advanced coal ITC
10 to GMO, the Company is also requesting that it be allowed to request a private letter
11 ruling from the IRS stating that the allocation is not a normalization violation before an
12 order is made final on this issue.

13 **Kansas City Earnings Taxes**

14 **Q: What concerns do you have concerning Mr. Harrison's testimony on Kansas City**
15 **earnings tax?**

16 A: By removing the Kansas City earnings tax from the income tax calculation and adding a
17 portion of KCP&L's 2009 Kansas City earnings tax paid to general taxes, Mr. Harrison is
18 ignoring the fundamental relationship between the Kansas City earnings tax and income
19 earned by KCP&L.

20 **Q: How is the Kansas City Earnings Tax calculated for tax return purposes?**

21 A: The Kansas City Code imposes a tax for general revenue purposes of 1.0 percent per year
22 on "net profits of all corporations earned as a result of work done or services performed
23 or rendered or business or other activities conducted in the city." Net profits are also

1 defined by the City as “the gross receipts from the operation of a business less deductions
2 for ordinary and necessary business expenses as determined for the purposes of federal
3 taxable income with adjustments.” The net profits are allocated to Kansas City, Missouri
4 based on a three-factor apportionment formula using property, payroll and gross receipts
5 generated or located in Kansas City, Missouri compared to total property, payroll and
6 gross receipts of the company.

7 **Q: How has Mr. Harrison computed earnings tax in this case?**

8 A: Mr. Harrison used the actual 2009 Kansas City earnings tax paid and allocated a portion
9 that expense to general taxes. He also removed or reduced that an estimated amount of
10 earning tax expense that he believes is associated with KCP&L Kansas City, Missouri
11 employees providing services to Kansas KCP&L and GMO customers. In his testimony,
12 he suggests that a study should be done to calculate a better estimate of the amount that
13 should be allocated to Kansas KCP&L and GMO customers.

14 **Q: Does Mr. Harrison’s method reflect an appropriate amount of earnings tax?**

15 A: No. In the cost of service schedules for this case, revenues and expenses are all
16 recomputed. Since the Kansas City earnings tax is based on the net profits of the
17 Company, the earnings tax should also be recomputed to reflect all of the adjustments
18 made to earnings of the company in the case. In fact, as stated earlier, Kansas City
19 earnings tax is computed using income and expenses “as determined for federal income
20 tax purposes.” Therefore, it should be recomputed in a fashion similar to how federal and
21 state income taxes are computed. The method used by the Company in this case and by
22 Staff and the Company in prior rate cases, treats Kansas City earnings tax in a similar
23 manner as federal and state income taxes. By using the 2009 actual earnings tax paid,

1 cost of service adjustments which impact KCP&L's earnings in the case are ignored.

2 This results in an improper amount of earnings tax included in the case.

3 **Q: Do you agree with Mr. Harrison that some of the earnings tax should be allocated to**
4 **Kansas KCP&L customers and to GMO customers?**

5 A: No. Some of the work spent by KCP&L employees in Kansas City, Missouri locations
6 may support Kansas KCP&L customers and GMO customers. However, work performed
7 at locations by KCP&L employees outside of Kansas City, Missouri also supports Kansas
8 City, Missouri KCP&L customers. A better estimate of payroll costs used to support
9 Kansas City, Missouri would be to use the gross receipts generated by Kansas City,
10 Missouri customers over total gross receipts to determine an estimate of compensation
11 used to support Kansas City, Missouri customers. Using the gross receipts factor to
12 estimate the payroll costs that should be allocated to KCP&L Kansas City, Missouri
13 customers assumes that all employees provide services to all customers and it allocates a
14 pro-rata amount of payroll cost to those customers based on revenue generated by those
15 customers.

16 The payroll factor used in computing the apportionment factor in Kansas City, Missouri
17 for 2009 is 42.1750%. This factor is very close to the factor for Kansas City, Missouri
18 gross receipts in 2009 of 42.8730%. Therefore, the total apportionment factor used to
19 calculate Kansas City earnings attributable to KCP&L Kansas City, Missouri customers
20 would be approximately the same even if the payroll factor was updated to reflect all
21 KCP&L employees providing services to all customers, including Kansas City, Missouri,
22 other Missouri locations, Kansas and GMO customers. Contrary to Mr. Harrison's

1 statement in his testimony, the Company believes that the allocation used to compute
2 Kansas City, Missouri earnings tax by the Company in this case is reasonable and proper.

3 **Q: Do you agree with Mr. Harrison that the method used by the Company in this case**
4 **and by the Staff in prior cases to compute Kansas City earnings tax overstates**
5 **costs?**

6 **A:** No. I do not. Although it is true that the actual Kansas City earnings tax has been less on
7 it actual tax returns than what has been included in the current case and in prior cases,
8 KCP&L has not actually generated the net earnings that are assumed in the each of the
9 cases either. There are many factors that cause this difference. One factor is that there
10 are several disallowed expenses removed from the cost of service schedules that the
11 Company must include on its tax return when filed. This reduces the actual amount of
12 earnings tax due on the tax return. But, the company should not be penalized by a
13 reduction of earnings tax associated with those expenses when the expenses are not
14 allowed in the case. In addition, the cost of service computations also include revenues
15 that are generated by increases in rates which are not effective until future periods. This
16 creates a timing issue between the amount of earnings tax computed in the current case
17 and when the earnings tax will be ultimately be due on the estimated revenue due to an
18 increase in rates. The Company should be able to compute the earnings tax that will be
19 due on revenue included in cost of service in the case. The last major difference is due to
20 increases in costs from the time that the rate case is prepared and actual costs incurred
21 that determine the earnings tax due on the tax return. All of these differences are
22 detriments to KCP&L that reduce tax on the Kansas City Earning Tax return, but should
23 not be factored into cost of service computations for earnings taxes.

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Excess Deferred Income Taxes

Q: What concerns do you have with Excess Deferred Income Taxes adjustment proposed by Mr. Harrison?

A: Mr. Harrison includes an adjustment to flow back excess deferred taxes over the approximate depreciable book life of the property for which the deferred taxes are associated. Mr. Harrison's adjustment does not appear to be adjusted for the change in depreciable book lives requested by the Staff in this case.

Q: Why do the excess deferred income taxes need to be adjusted?

A: The IRS requires that the excess deferred taxes be flowed back the ratepayers not more rapidly than by a proportionate amount of deferred taxes when the timing differences related the same property reverses for the same period. Since book depreciation is needed to determine how much of the timing differences reverse in a period, a change to the book depreciation rates will impact the amount of excess deferred taxes that should be flowed back to ratepayers.

Q: What is the penalty by the IRS if more excess deferred taxes are flowed back to ratepayers than should be in setting rates?

A: This is also considered a normalization violation by the IRS and the penalty for a violation of this nature is a loss of the use of accelerated depreciation when computing the Company's federal tax liability. This penalty would create significant harm to ratepayers. The deferred taxes created by accelerated depreciation are a significant reduction to rate base. Without accelerated depreciation, KCP&L would pay income taxes much sooner and it would need a higher revenue requirement cover those tax payments.

1

Advanced Coal Credit Arbitration Costs

2 **Q: Please describe the advanced coal credit arbitration cost issue.**

3 A: Mr. Majors made an adjustment to remove \$41,764 of test year outside service costs
4 which related to an arbitration case associated with the advanced coal ITC received by
5 KCP&L.

6 **Q: Do you agree with Mr. Majors' adjustment?**

7 A: No, I do not.

8 **Q: Briefly explain why the company was involved in arbitration over this credit.**

9 A: As stated previously, an advanced coal credit is an investment tax credit (ITC) allocated
10 to qualifying advanced coal projects by the Internal Revenue Service. KCP&L was
11 initially allocated \$125 million of advanced coal ITC for its qualified investment in Iatan
12 Unit 2 in 2008. The Empire District Electric Company, Kansas Electric Power
13 Cooperative, and Missouri Joint Municipal Electric Utility Commission, certain joint
14 owners of Iatan Unit 2, filed a notice to arbitrate in 2009, asserting that they were entitled
15 to receive proportionate shares (or the monetary equivalent) of the \$125 million of
16 advanced coal credits allocated to KCP&L. As independent entities, the joint owners are
17 taxed separately, and the joint owners do not dispute that they did not timely file for the
18 credit themselves. Notwithstanding this, the joint owners contended that they should
19 receive proportional shares of the credit. KCP&L disagreed and the matter was heard by
20 an arbitration panel in November 2009.

21 **Q: Why does the company disagree with Mr. Majors' proposed disallowance of these**
22 **costs?**

1 A: The arbitration was for the purpose of maximizing the Company's advanced coal ITC.
2 This advanced coal ITC is flowed back to the ratepayers, much like the investment tax
3 credits that have been flowed back in prior years. Therefore, since KCP&L entered into
4 the arbitration to maximize the benefit to ratepayers, it is only logical that costs incurred
5 associated with the arbitration should be included in costs recovered by the Company.

6 Q: **Does that conclude your testimony?**

7 A: Yes, it does.

