Exhibit No.:

Issue:

ISRS Accumulated Deferred Income Taxes

Witness:

Karen Lyons MoPSC Staff

Sponsoring Party: Type of Exhibit: Case No.:

Rebuttal Testimony WO-2019-0184

Date Testimony Prepared:

May 13, 2019

MISSOURI PUBLIC SERVICE COMMISSION **COMMISSION STAFF DIVISION**

AUDITING DEPARTMENT



MAY 2 1 2019

REBUTTAL TESTIMONY Service Commission

OF

KAREN LYONS

MISSOURI-AMERICAN WATER COMPANY CASE NO. WO-2019-0184

> Jefferson City, Missouri May 2019

Date 5/11/19 Reporter M

1		REBUTTAL TESTIMONY						
2		OF						
3		KAREN LYONS						
4		MISSOURI-AMERICAN WATER COMPANY						
5		CASE NO. WO-2019-0184						
6	Q.	Please state your name, employment position, and business address.						
7	A.	Karen Lyons, Utility Regulatory Auditor with the Missouri Public Service						
8	Commission	("Commission" or "PSC"), Fletcher Daniels State Office Building, 615 East 13th						
9	Street, Kansa	as City, Missouri 64106.						
10	Q.	Are you the same Karen Lyons who contributed to Staff's Recommendation						
11	filed April 22, 2019, and direct testimony filed on May 7, 2019, in this case?							
12	· A.	Yes.						
13	Q.	What is the purpose of your rebuttal testimony?						
14	A.	The purpose of my rebuttal testimony is to respond to the proposal by						
15	Missouri-An	nerican Water Company ("MAWC") witnesses John R. Wilde and Brian W.						
16	LaGrand to	offset MAWC's Infrastructure System Replacement Surcharge ("ISRS") deferred						
17	tax liability	with a deferred tax asset that consists of a hypothetical net operating loss						
18	("NOL").							
19	Q.	Does Staff have any corrections to its reconciliation filed with its						
20	recommenda	tion as Appendix B on April 22, 2019?						
21	A.	Yes. Staff included an incorrect amount for the NOL difference between						
22	MAWC and	Staff. Staff updated the reconciliation to reflect the correct amount for the NOL						
23	issue and atta	sched it to this testimony as Schedule KL-r1.						

- Q. Does Staff agree with Mr. Wilde when he states that accumulated deferred income taxes include both deferred tax liabilities and deferred tax assets?¹
- A. Yes, as long as the deferred tax liabilities and deferred tax assets in question are related to deductions for costs included in the utility cost of service. However, in this ISRS petition, it is Staff's opinion that MAWC has not generated NOLs associated with ISRS investment for the current ISRS period of October 1, 2018, through March 31, 2019, as well as the previous ISRS period of January 1, 2018, through September 30, 2018. The Tax Cuts and Jobs Act ("TCJA"), passed in December of 2017, changed the tax law to eliminate the availability of bonus depreciation deductions which has historically been the main cause of NOLs incurred by utilities.
- Q. Does MAWC's proposed calculation of the NOL using the "with and without" method make sense in this proceeding?
- A. No. In Missouri, direct rate recovery of investment by a utility can only occur after that investment is in service. If you take the approach of subtracting the incremental tax deductions associated with new ISRS plant investment from an assumed level of zero incremental revenues for the same additions, a hypothetical net operating loss amount will be calculated every time, whether the utility is actually generating incremental NOL or not. There could be a situation in the future when an actual NOL may be generated due to ISRS investment, but in that case, a different method of calculation will need to be considered in order to allocate appropriately an overall NOL value to incremental ISRS investment. At a

[.] John R. Wilde Direct Testimony, page 4, lines 17-18.

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directly related to ISRS plant additions.

1 minimum, a pro rata ratio of ISRS plant additions to non-ISRS plant additions would need to be used to calculate the portion of the NOL reasonably attributable to ISRS plant additions. 2 3 0. Is it possible to determine what specific ratemaking elements give rise to an NOL? 4 5 A. NOLs are calculated on an overall basis and are not split out for No. 6 accounting purposes by the various tax deductions that may contribute to an NOL situation. 7 Q. What is the repairs deduction and associated "Consent Agreement" that 8 Mr. Wilde mentions on page 12, lines 6-9 of his testimony? A. In 2010, American Water Works Inc. and its subsidiaries requested permission 9 10 from the IRS to change their method of tax accounting for costs associated with routine repair 11 and maintenance of tangible property. MAWC's request was granted, subject to the 12 conditions outlined in the Consent Agreement with the IRS. This agreement is attached to the 13 direct testimony of MAWC witness Wilde as Schedule JRW-6. The repairs tax deduction 14 covers costs that are incurred to keep the taxpayer's property in efficient operating condition 15 and that do not materially increase the value of the property or increase its useful life. 16 Q. Is a repairs deduction appropriate to reflect in MAWC ISRS cases? 17 Yes. The deferred tax liability associated with the repair allowance deduction A. 18 is appropriate to include in ISRS rates because the costs associated with this deduction are

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Mr. Wilde discusses the Consent Agreement related to the tax repairs Q. deduction that MAWC was able to begin taking.² Does Staff believe that its recommendation in this case would cause a normalization violation regarding the repairs deduction?

No. Staff agrees the Consent Agreement with the IRS requires MAWC to A. follow normalization accounting regarding its repairs deduction, and Staff has applied normalization accounting in its treatment of the repair allowance in this case. Staff included the deferred tax liability relating to the repairs allowance deduction in its recommended ISRS rate base; however, it is Staff's position that MAWC has not generated any NOL deferred tax asset related to either accelerated depreciation deductions or repair allowance deductions in the current ISRS period or the prior ISRS period. This is evident by MAWC's declining NOL balances over time.³

On page 15, lines 12-15, Wilde states "Staff only attributes the term Q. 'hypothetical' to the NOL DTA [Deferred Tax Asset] that they suggest should be excluded from the ISRS rate base, yet this amount is no more or less an estimate and 'hypothetical' than the DTL [Deferred Tax Liability] generated in claiming tax depreciation and tax repairs." Does Staff agree with this assessment?

A. No. Staff understands that MAWC uses accrual accounting to record estimates of its deferred tax assets and liabilities on its financial reporting books and may "true-up" these amounts with updated information later. When Staff called the deferred tax asset "hypothetical," it meant that MAWC calculated an NOL solely for purposes of this ISRS proceeding, while no such NOL deferred tax asset was actually booked by MAWC during the

² John R. Wilde, Direct Testimony, beginning on page 17, line 20.

³ Lyons Direct Testimony, MAWC Historical NOL Balances, page 6.

Rebuttal Testimony of Karen Lyons

- 1 ISRS period. Assuming the existence of an NOL when no such amount at all is recorded on a
- 2 utility's books is very different than relying on actual book information for the amount of
- 3 accelerated depreciation deferred tax liabilities, even if such amounts may be subject to
- 4 change later.
- 5 Q. Does this conclude your rebuttal testimony?
- 6 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

Water Company fo	r Appro	f Missouri-American val to Change an lacement Surcharge)))	Case No. WO-2019-0184 Tariff No. YW-2019-0018
		AFFIDAVIT OF KARE	N LYONS	<u> </u>
State of Missouri)) ss.)			
County of Cole				

COMES NOW, Karen Lyons, and on her oath declares that she is of sound mind and lawful age; that she contributed to the attached *Rebuttal Testimony*; and that the same is true and correct according to her best knowledge and belief.

Further the Affiant sayeth not.

Naren Lyons

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 13 h day of May, 2019.

D. SUZIE MANKIN
Notary Public - Notary Seat
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2020
Commission Number: 12412070

NOTARY PUBLIC

Property Taxes

ISRS Undercollection

Revenue Requirement Before Interest Deductibility

		75/14 *	//AWC Filed	MA	WC Updated				Amount of NOL	fill to and	al STAFF and
Plant Additions - Replacement	s	<u> </u>	Application	14/34/5	Position		taff's Position	<u> </u>	Removed	MAV	VC Differences
	Gross Plant Additions	— _s	53,498,915	\$	65,156,806	¢	65,156,806			ė	
	CIAC	Ś	(10,928)		(10,928)		(10,928)			ç	~
	Deferred Taxes	Ś	(548,022)		(522,256)		(9,222,666)	¢	(8,700,410)	ş S	(8,700,410)
	Accumulated Depreciation	\$	(282,134)	•	(309,021)	,	(309,021)	Y	(8,700,410)	٠	(8,700,410)
Total Net Main Replacements	·	\$	52,657,831		64,314,601		55,614,191	\$	(8,700,410)	\$	(8,700,410
Plant Additions - Relocations											
	Gross Plant Additions	 \$	1,149,549	\$	1,010,834	Ś	1,010,834				
	CIAC	\$	(298,250)	,	(298,250)		(298,250)				
	Deferred Taxes	\$	(42,648)	\$	(3,856)	Ś	(68,099)	Ś	(64,243)	Ś	(64,243)
	Accumulated Depreciation	\$	(7,980)	\$	(7,484)	\$	(7,484)	•	\- · / = · 2 /	Ś	(* ') '-
Total Net Relocations		\$	800,671	\$	701,244	\$	637,001	\$	(64,243)	\$	(64,243
	Accumulated Deprec. prior to ISRS Deferred Taxes prior to ISRS	 \$ \$	(441,997) (18,781)		(441,997) (18,781)		(441,997) (18,781)				
Total Acc. Deprec. And Deferred Taxes on Investment in Current ISRS			(460,778)	\$	(460,778)	\$	(460,778)	\$	-	\$	<u></u>
TOTAL ISRS NET PLANT ADDITIONS			52,997,724	\$	64,555,067	:\$.	55,790,414	\$	(8,764,653)	 \$	(8,764,653)
	CALCULA	TION OF	ISRS REVENUE	REQU	JIREMENT						
		1	//AWC Filed	ļķ.	WC Updated Position		taff's Position	Ai	mount of NOL Removed	de la colo	al STAFF and
	•		-hhuangan ()				can a roamon	<u>, 11 - 14</u>	NGHIOVEU - 1 1	IVIAVI	oc omerences
Total ISRS Net Plant Additions		\$	52,997,724	\$	64,555,067	\$	55,790,414	\$	(8,764,653)	\$	(8,764,653)
Overall Pretax Rate of Return			9.44%		9.44%		9.44%		9.44%		,,==,
Revenue Requirement on Capit	al	\$	5,002,985	\$	6,093,998	\$	5,266,615	\$	(827,383)	\$	(827,383
Depreciation Expense		\$	662,746	\$	873,085	\$	873,085			\$	-
Dranorty Tayor	·			a.			•				

2,739,347 \$

\$ - \$

2,739,145 \$

9,706,228 \$

2,739,145

8,878,845 \$

(827,383) \$ (827,383)