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| **Exhibit No:** | |
| **Issue:** | **Income Taxes** |
| **Witness:** | **Chuck J. Kuper** |
| **Type of Exhibit:** | **Direct Testimony** |
| **Sponsoring Party:** | **Spire Missouri Inc.** |
| **Case Nos.:** | **GO-2019-0356; GO-2019-0357** |
| **Date Prepared:** | **September 27, 2019** |

**SPIRE MISSOURI INC.**

**GO-2019-0356**
**GO-2019-0357**

# DIRECT TESTIMONY

**OF**

**CHUCK J. KUPER**

**September 2019**

Spire Exhibit No. 8
Date 10-2-19 Reporter TM
File No. GO-2019-0356
GO-2019-0357

1 **DIRECT TESTIMONY OF CHUCK J. KUPER**

2 Q. **PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A. My name is Chuck J. Kuper and my business address is 700 Market St., St. Louis, Missouri, 63101.

3 Q. **WHAT IS YOUR PRESENT POSITION?**

4 A. I am employed by Spire Inc. as Director, Tax.

5 Q. **PLEASE STATE HOW LONG YOU HAVE HELD YOUR POSITION AND**
6 **BRIEFLY DESCRIBE YOUR RESPONSIBILITIES.**

7 A. I have held this position since I joined Spire in 2015. From January 2017 to July 2018 I
8 was also responsible for External Financial Reporting. My current responsibilities include
9 tax accounting, tax compliance, tax audits and tax planning.

10 Q. **WHAT WAS YOUR PROFESSIONAL EXPERIENCE PRIOR TO ASSUMING**
11 **YOUR CURRENT POSITION?**

12 A. Prior to joining Spire, I was employed with Lumara Health, Inc. as their Senior Director,
13 Reporting & Tax. I worked for Lumara Health from 2000 to 2015. When I first joined
14 Lumara Health, I served as Director, Tax. I was promoted to Senior Director, Tax in 2007
15 and then added the Reporting function in 2013. Before joining Lumara Health, I worked
16 for Hussmann Corporation as their International Tax Manager from 1998 to 2000. I spent
17 approximately 11 years working with two national public accounting firms (Arthur
18 Andersen & KPMG) prior to these roles.

19 Q. **WHAT IS YOUR EDUCATIONAL BACKGROUND?**

1 A. I hold a Master of Accountancy with a Tax emphasis from Southern Illinois University at
2 Carbondale, Illinois which I received in 1987 and a Bachelor of Science in Accounting
3 from Southern Illinois University at Carbondale, Illinois, which I received in 1986.

4 Q. **HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE THIS COMMISSION?**

5 A. Yes, I filed testimony in Spire Missouri's last rate case proceedings, Case Nos. GR-2017-
6 0215 and GR-2017-0216 and in its last ISRS proceedings, Case Nos. GO-2019-0115 and
7 GO-2019-0116.

8 Q. **WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

9 A. The purpose of my testimony is to respond to Staff's September 13, 2019 recommendation
10 in these cases to allow no amount for income taxes because the Company's current tax
11 liability has been offset by certain tax deductions associated with the installation of ISRS
12 facilities. As I will explain below, Staff's elimination of any allowance for income taxes
13 should be rejected by the Commission for two primary reasons.

14 First, Staff's adjustment is inconsistent with the provisions of the ISRS Statute that specify
15 how income taxes are to be calculated in the development of an ISRS revenue requirement.
16 In effect, Staff's adjustment ignores the Statute's instruction to consider only tax rates, and
17 instead looks behind those rates to apply specific deductions.

18 Second, Staff's adjustment results in a "double dip" by including 263A tax deductions in
19 the calculation of the Company's ISRS revenues in these cases even though 263A
20 deductions are already reflected in rates. In fact, the end result of Staff's adjustment would
21 be to include in rates amounts for these 263A deductions that significantly exceed the
22 overall level of 263A deductions actually taken by the Company.

23

1 **BACKGROUND**

2 **Q. CAN YOU PLEASE PROVIDE THE COMMISSION WITH SOME HISTORICAL**
3 **BACKGROUND ON THE TAX ISSUE RAISED BY STAFF IN ITS**
4 **RECOMMENDATION?**

5 A. Yes, this issue principally relates to tax deductions that the Company takes in connection
6 with transferring services from old mains to new mains, as well as deductions taken by the
7 Company pursuant to Section 263A of the Internal Revenue Code (the "263A Deduction")
8 for administrative and overhead costs relating to its self-constructed assets, most notably
9 those ISRS-related investments made to replace or relocate mains, services and other
10 facilities. These costs are capitalized on the Company's books and depreciated, but
11 expensed and deducted for tax purposes. Also, some of these costs could qualify as a repair
12 deduction and would not affect the 263A calculation.

13 **Q. HOW DO THESE DEDUCTIONS IMPACT THE COMPANY?**

14 A. By taking these deductions, the Company is able to lower its current taxable income and
15 may be able to obtain a source of cash resulting from taxes it does not have to pay
16 immediately which cash is, in turn, used to help finance the investments in capital the
17 Company is making. However, these deductions are essentially timing in nature, and will
18 reverse in future periods resulting in increased taxable income in those future years. To
19 obtain those deductions, the Company expenses for tax purposes certain costs it capitalizes
20 for book purposes associated with these investments, including the payroll and benefits of
21 the employees (or the charges of their third party contractors) who are performing the actual
22 construction work, as well as the administrative overhead expenses of the engineers,
23 corporate support services and other administrative functions and costs typically assigned

1 to such work. Since these costs are deducted for tax in the year incurred, the entire amount
2 is expensed. For book purposes, these costs are capitalized and depreciated. In subsequent
3 years, there will be a depreciation expense for book purposes with no tax deduction. Over
4 the entire length of time the property is in service, the book deductions will be taken to
5 equal the tax deduction taken in the first year.

6 **Q. HOW DOES THIS APPROACH TOWARDS CAPITALIZING AND DEDUCTING**
7 **SUCH COSTS IMPACT CUSTOMERS?**

8 A. The Company flows through the tax benefits of these deductions in its rate cases based on
9 Commission guidance from prior rate cases, so current customers enjoy lower rates due to
10 lower tax expense. However, these deductions are timing and will create an increase to
11 rates in future periods when these deductions reverse and cause tax expense to increase.
12 These deductions are essentially a normalized item that the Commission has provided
13 guidance to treat as a flow through item.

14 **Q. WHEN AND HOW DID THIS TAX ISSUE ARISE?**

15 A. Shortly after the Commission promulgated its rules to implement the ISRS Statute, the
16 Company made an ISRS filing in Case No. GO-2004-0443. In submitting its
17 recommendation in that case, the Staff proposed to do what it is doing here: reduce the
18 ISRS by the full value of the 263A tax deductions. The Company opposed Staff's
19 treatment, but the parties ultimately reached an agreement under which they "split the
20 difference" on the value of the issue for ISRS purposes on the condition that the parties
21 would expedite implementation of the Company's ISRS filings. That agreement was
22 approved and recognized in both ISRS and rate case proceedings until very recently. Over
23 the past several years, however, the Company has not received the benefit of expedited

1 ISRS filings, primarily because OPC has opposed one or more elements of the Company's
2 filing and requested a hearing, thereby necessitating the use of the entire ISRS period.

3 **Q. DID THE COMPANY, STAFF AND OPC SEEK TO REACH A RESOLUTION OF**
4 **THIS ISSUE AFTER THE COMPANY'S MOST RECENT RATE CASES WERE**
5 **CONCLUDED?**

6 A. Yes. Pursuant to the Stipulation and Agreement approved in those rate cases, the parties
7 met in an effort to determine whether they could develop an approach to this issue that
8 would be mutually acceptable to all parties. The Company remains open to resolving this
9 issue with all of the parties. Absent a resolution, however, the Commission should approve
10 the Company's approach that includes taxes at current rates, as prescribed by the ISRS
11 Statute, and deny Staff's proposal that conflicts with the ISRS Statute and double counts
12 tax deductions.

13 <u>**INCONSISTENCY WITH ISRS STATUTE**</u>

14 **Q. WHAT DOES THE ISRS STATUTE PROVIDE IN TERMS OF HOW AN ISRS**
15 **REVENUE REQUIREMENT IS TO BE DETERMINED?**

16 A. Section 393.1009 states that the ISRS mechanism is designed to provide "appropriate pre-
17 tax revenues" which is further defined as:

18 "the revenues necessary to produce net operating income equal to:

19 (a) The gas corporation's weighted cost of capital multiplied by the net original
20 cost of eligible infrastructure system replacements, including recognition of
21 accumulated deferred income taxes and accumulated depreciation associated
22 with eligible infrastructure system replacements which are included in a currently
23 effective ISRS; and

24 (b) Recover state, federal, and local income or excise taxes applicable to such
25 income; and

(c) Recover all other ISRS costs."

This definition of "appropriate pre-tax revenue" is further refined by Section 393.1015(4), which states in part,

> "4. In determining the appropriate pretax revenue, the commission shall consider only the following factors:
>
> (1) The current state, federal, and local income tax or excise *rates*;" (*emphasis added*)

**Q. HOW ARE "ALL OTHER ISRS COSTS" DEFINED?**

A. According to the ISRS Rule passed by the Commission, "other ISRS costs" are defined as the:

> "annual depreciation expenses, and property taxes that will be due within twelve (12) months of the ISRS filing on the total cost of eligible infrastructure system replacements less annual depreciation expense and property taxes on any related facility retirements."

**Q. IN WHAT WAY DOES THE STAFF'S PROPOSED ADJUSTMENT DEVIATE FROM THESE STATUTORY PROVISIONS AND THE COMMISSION'S OWN RULES?**

A. For the ISRS investments at issue in these cases, the Staff has reflected in its calculation of ISRS revenues the "flow-through" tax treatment that is currently afforded to transfer of services and the book/tax capitalization differences resulting from the 263A deductions (even though both items are fully reflected in rates already, as discussed below). Specifically, the Staff has applied this "flow-through" tax treatment to this one type of expense as an offset to the income tax "gross-up" necessary to recover the "appropriate pre-tax revenue" and "net operating income" provided for in the ISRS Statute and Rule.

1 **Q. IS THE OFFSET RECOMMENDED BY THE STAFF RELATED TO THESE TWO**
2 **ITEMS ADDRESSED IN OR CONTEMPLATED BY THE ISRS STATUTES OR**
3 **RULE?**

4 A. No. As previously noted, the only income tax related items open for consideration are the
5 "current state, federal, and local income tax or excise rates" applicable to the net operating
6 income on ISRS-eligible property.

7 **Q. PLEASE EXPLAIN.**

8 A. The ISRS Statute and ISRS Rule states that the ISRS should: "[r]ecover state, federal, and
9 local income or excise taxes applicable to such income ..." By using the term "recover" this
10 language clearly contemplates that there would be a positive tax amount associated with
11 the income calculated pursuant to the preceding paragraph (a) of the Statute. This is further
12 buttressed by another provision of the Statute, namely Section 393.1015(4)(1). As
13 previously noted, that Section states that in determining ISRS revenues, the ***only*** factor that
14 the Commission is to consider in terms of income taxes, is the "... current state, federal,
15 and local income tax or excise ***rates;"*** (emphasis supplied). When considered together,
16 these provisions establish a very straightforward and simple methodology for determining
17 the income tax component of an ISRS filing, i.e. that component is determined by applying
18 the state, federal and local income tax "rates" to the income amount calculated under
19 Section 393.1009(1)(a). By applying the income tax deductions to reduce revenue, the
20 result is to reduce current taxable income. It does not change the fact that taxes will be due
21 on this revenue at some point in future periods when these deductions reverse. Without
22 allowing taxes to be considered as part of the revenue requirement, there will be a shortfall
23 during the reversal periods. That is in addition to the fact that such an approach reflects in

1 rates an allowance for such deductions that is far in excess of the value of the deductions
2 actually received by the Company.

3 **Q. IS THERE ANYTHING IN THIS LANGUAGE TO INDICATE THAT TAX**
4 **DEDUCTIONS ASSOCIATED WITH PARTICULAR ISRS INVESTMENTS MAY**
5 **BE CONSIDERED BY THE COMMISSION?**

6 A. No, there is nothing in the language of these provisions to suggest, as the Staff has, that the
7 Commission may go beyond this straightforward calculation and also examine issues such
8 as the level of tax deductions associated with an ISRS investment. In fact, it indicates just
9 the opposite by limiting the Commission to a consideration of tax rates. Staff's own
10 Memorandum that was submitted when this issue was first raised by Staff in 2004 explicitly
11 recognized the absence of language authorizing such a consideration when it attempts to
12 rephrase the language of the ISRS Statute to accommodate Staff's proposed method for
13 calculating taxes. As set forth at page 4 of its April 26, 2004 Memorandum submitted in
14 Case No. GO-2004-0443, Staff stated that the ISRS should "recover state, federal, and local
15 income or excise taxes applicable to such income **(including all applicable tax**
16 **deductions)"** (emphasis supplied). Staff may indeed have believed that the computation
17 of ISRS revenues should include a consideration of "all applicable tax deductions."
18 However, the parenthetical language necessary to authorize such a consideration exists
19 only on page 4 of Staff's Memorandum. It does ***not*** exist, however, in either the ISRS
20 Statute or the ISRS Rule. Staff's language demonstrates the difference between what the
21 ISRS Statute actually says and what it would have to say to authorize Staff's proposed
22 method for calculating taxes. Simply put, if the legislature had wanted tax deductions to be

1 considered and flowed-through in the calculation of ISRS revenues, it would have
2 incorporated language to that effect into the ISRS Statute. It did not. Instead, in requiring
3 the Commission to process these cases in 120 days, the legislature specifically limited the
4 matters to be considered by the Commission. With respect to taxes, the Commission may
5 only consider tax rates; it is not authorized to grapple with tax deductions.

6 **Q. ARE THERE ANY OTHER REASONS WHY YOU BELIEVE THE FLOW-**
7 **THROUGH OF TAX DEDUCTIONS IS NOT CONTEMPLATED BY THE ISRS**
8 **STATUTE?**

9 A. Yes. Where the ISRS Statute wishes to have a particular revenue or expense item
10 considered in the calculation of ISRS revenues, it describes those items using technical
11 terms that have been long-established and widely-recognized in the regulatory arena. For
12 example, the ISRS Statute uses such terms as "accumulated deferred income taxes" and
13 "accumulated depreciation" in describing the items that are to be considered when
14 calculating ISRS revenues. Each of these technical terms has a very specific meaning in
15 the ratemaking process and their inclusion in the ISRS Statute demonstrates the pains that
16 the legislature took to describe exactly how the Commission was to calculate ISRS
17 revenues and what items would be considered in that calculation. In much the same way,
18 the term "flow-through" is also a technical term that has a very specific meaning in the
19 regulatory process when it comes to calculating taxes. Indeed, I understand that the term
20 has long been used in numerous Commission cases to describe the very kind of tax
21 treatment that Staff is proposing in this case. The fact that this technical term, unlike the
22 others described above, is nowhere to be found in the ISRS Statute is another fact indicating

1 that Staff's proposed tax treatment was not contemplated by the Statute and, indeed, is
2 precluded by it.

3 **DOUBLE COUNTING**

4 **Q. ARE THE LANGUAGE OF THE ISRS STATUTE AND RULE THE ONLY**
5 **REASONS WHY THE COMPANY BELIEVES THAT THE STAFF'S PROPOSED**
6 **TAX TREATMENT IS INAPPROPRIATE?**

7 A. No. This issue must, of course, be decided based on what the ISRS Statute says, no matter
8 what a party's individual views of the Statute may be. That said, however, it is important
9 for the Commission to recognize that Staff's proposed tax treatment is also fundamentally
10 unfair in that it seeks to double count the tax deductions associated with ISRS projects. An
11 annualized level of tax deductions associated with the Company's investments is already
12 reflected in the Company's rates, and reflecting an additional level of deductions, as Staff
13 has proposed to do, amounts to a double counting of deductions.

14 **Q. CAN YOU IDENTIFY WHAT AMOUNTS ASSOCIATED WITH THE 263A**
15 **DEDUCTIONS WERE FLOWED THROUGH IN THE COMPANY'S LAST RATE**
16 **CASES?**

17 A. Yes, Schedule CJK-1, which is attached to my direct testimony and incorporated herein for
18 all purposes, contains the relevant Staff tax schedules from the Company's last rate cases.
19 As shown by Staff's tax schedules, the amount of 263A deductions have reduced income
20 for Spire Missouri East on line 17 by $16,196,036, and for Spire Missouri West on line 12
21 by $10,850,002. It is important to note that 263A deductions are one-time deductions for
22 income tax purposes that occur each year for the assets that were constructed that year.

1 Once the asset is "expensed" for tax purposes, it is, in effect, fully depreciated and cannot
2 be expensed or depreciated again. Since the revenue requirement in the rate cases reflect
3 a total of $27 million in *ongoing annualized allowances* for such deductions, the customers
4 are already receiving the benefit of annualized 263A deductions each year of $27 million.
5 By accounting for the 263A deductions again in these ISRS cases, Staff is double counting
6 these deductions. Stated another way, Spire has already provided customers the benefits
7 of these deductions in base rates and should not be made to provide them again through
8 this ISRS.

9 Q. **CAN YOU ILLUSTRATE HOW ADOPTION OF STAFF'S PROPOSED**
10 **TREATMENT OF THESE TAX DEDUCTIONS WOULD RESULT IN AN OVER-**
11 **RECOGNITION OF SUCH DEDUCTIONS?**

12 A. Yes. This inappropriate impact can be seen by simply comparing the actual, annualized
13 amount of 263A deductions that have or will be taken by the Company to the amounts that
14 would be imputed in rates under the approach recommended by the Company versus the
15 amount imputed under the approach recommended by Staff.

16 Q. **WHAT DOES SUCH A COMPARISON SHOW IN TERMS OF SPIRE EAST?**

17 A. Looking at Spire East first, the Company has taken (or will take) approximately $30 million
18 in cumulative 263A tax deductions over the three-year period beginning with the fiscal
19 2017 tax year, which is the period after the test year amount included in rates. This is
20 already less than the $48.6 million in 263A deductions that will be flowed through to
21 customers over the same period as a result of the ongoing allowance for this tax component

1 that was built into rates in Spire East's last rate case proceeding. Nevertheless, such
2 differences, unless they are artificially increased by Staff's attempt to double count the
3 263A deductions, are reasonably in line with the variations that can occur in various cost
4 components between rate cases. That is precisely why the Company supports limiting the
5 flow-through of 263A deductions to the ongoing allowance that was imputed in the rate
6 case and not recognizing incremental 263A deductions in each ISRS case.

7 **Q. ARE THE RESULTS THE SAME FOR SPIRE WEST?**

8 A. Yes. The same comparison would produce similar results for Spire West. Spire West has
9 approximately $32.5 million of 263A deductions included in the current rate structure for
10 the three years following the test year. The actual 263A deductions taken or to be taken
11 will approximate $28.5 million over the same three year period.

12 **Q. HAS THE STAFF PREVIOUSLY RECOGNIZED THAT IT IS CONTRARY TO**
13 **THIS ISRS STATUTE AS WELL AS GOOD REGULATORY POLICY TO**
14 **PERMIT A DOUBLE RECOGNITION OF AN ITEM THAT IS ALREADY**
15 **EMBEDDED IN RATES?**

16 A. Yes. For example, the Staff has previously raised this very point in arguing why the
17 Commission should not permit Missouri American Water Company ("MAWC") to recover
18 its net cost of removal in its ISRS filing. Specifically, the Staff has argued that it is
19 inappropriate because there was already an allowance for removal costs embedded in
20 MAWC's rates, and recognition of such costs in the utility's ISRS filing would therefore
21 result in a double-recovery. In addition to arguing that such a result was by its very nature

1 inappropriate, the Staff also contended that such a double-recovery was never
2 contemplated or sanctioned by the ISRS Statute. The very same considerations are equally
3 applicable to what Staff has attempted to do in this case with its proposed tax treatment of
4 Section 263A deductions. For the very reasons that the Staff was right in opposing a double
5 recovery of removal costs in MAWC's ISRS case, it is wrong for seeking a double
6 recognition of these tax benefits in this case. The Commission can and should be consistent,
7 however, by rejecting Staff's proposed tax treatment in this case just as it rejected MAWC's
8 treatment of cost of removal in that case.

9 Q. **DOES THIS COMPLETE YOUR DIRECT TESTIMONY?**

10 A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION**
**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of the Application of Spire Missouri Inc. to Change its Infrastructure System Replacement Surcharge in its Spire Missouri East Service Territory | ) | **File No. GO-2019-0356** |
| In the Matter of the Application of Spire Missouri Inc. to Change its Infrastructure System Replacement Surcharge in its Spire Missouri West Service Territory | ) | **File No. GO-2019-0357** |

AFFIDAVIT

STATE OF MISSOURI )
) SS.
CITY OF ST. LOUIS )

Chuck J. Kuper, of lawful age, being first duly sworn, deposes and states:

1. My name is Chuck J. Kuper. I am the Director, Tax for Spire Missouri Inc. My business address is 700 Market St., St Louis, Missouri, 63101.

2. Attached hereto and made a part hereof for all purposes is my direct testimony on behalf of Spire Missouri Inc.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Chuck J. Kuper

Subscribed and sworn to before me this 27th day of September 2019.

LISA M. REED
Notary Public - Notary Seal
STATE OF MISSOURI
St. Charles County
My Commission Expires: Nov. 7, 2019
Commission # 11265169

Notary Public