Exhibit No.:

Issue: ISRS Accumulated

Deferred Income Taxes

Witness: Karen Lyons

Sponsoring Party: MoPSC Staff
Type of Exhibit: Rebuttal Testimony

Case No.: WO-2019-0184

Date Testimony Prepared: May 13, 2019

## MISSOURI PUBLIC SERVICE COMMISSION COMMISSION STAFF DIVISION

AUDITING DEPARTMENT

REBUTTAL TESTIMONY

**OF** 

**KAREN LYONS** 

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

Jefferson City, Missouri May 2019

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	2, 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	ached it to this testimony as Schedule KL-r1.

- 1 2

- Q. Does Staff agree with Mr. Wilde when he states that accumulated deferred income taxes include both deferred tax liabilities and deferred tax assets?<sup>1</sup>
- 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

<sup>&</sup>lt;sup>1</sup> John R. Wilde Direct Testimony, page 4, lines 17-18.

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

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

A. No. Staff agrees the Consent Agreement with the IRS requires MAWC to 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.<sup>3</sup>

Q. On page 15, lines 12-15, Wilde states "Staff only attributes the term '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

<sup>&</sup>lt;sup>2</sup> John R. Wilde, Direct Testimony, beginning on page 17, line 20.

<sup>&</sup>lt;sup>3</sup> 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	Missouri-American val to Change an lacement Surcharge	) ) )	Case No. WO-2019-0184 Tariff No. YW-2019-0018
		AFFIDAVIT OF KAF	REN LYONS	<u>3</u>
State of Missouri	)			
County of Cole	) ss. )			

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.

D. SUZIE MANKIN Notary Public - Notary Seal State of Missouri

## <u>JURAT</u>

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 <u>13<sup>th</sup></u> day of May, 2019.

Commissioned for Cole County

My Commission Expires: December 12, 2020

Commission Number: 12412070

		r	MAWC Filed	N	MAWC Updated				Amount of NOL	Tot	tal STAFF and
		4	Application		Position	St	aff's Position		Removed	MAN	<b>NC Differences</b>
Plant Additions - Replacement	S										
	Gross Plant Additions	\$	53,498,915	\$	65,156,806	\$	65,156,806			\$	-
	CIAC	\$	(10,928)	\$	(10,928)	\$	(10,928)			\$	-
	Deferred Taxes	\$	(548,022)	\$	(522,256)	\$	(9,222,666)	\$	(8,700,410)	\$	(8,700,410)
	Accumulated Depreciation	\$	(282,134)	\$	(309,021)	\$	(309,021)			\$	-
<b>Total Net Main Replacements</b>		\$	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	\$	1,010,834				
	CIAC	\$	(298,250)	\$	(298,250)	\$	(298,250)				
	Deferred Taxes	\$	(42,648)	\$	(3,856)	\$	(68,099)	\$	(64,243)	\$	(64,243)
	Accumulated Depreciation	\$	(7,980)	\$	(7,484)	\$	(7,484)			\$	-
Total Net Relocations		\$	800,671	\$	701,244	\$	637,001	\$	(64,243)	\$	(64,243)
Assumed the department and Defe	Toward Toward Investment in Comment ISBS										
Accumulated Deprec. and Dere	Accumulated Deprec. prior to ISRS	_ ,	(441,997)	ċ	(441,997)	ċ	(441,997)				
	Deferred Taxes prior to ISRS	ې د	(18,781)	-			(18,781)				
Tatal Ass Danuas And Dafanua	•	<u>ې</u>						,		<u>,</u>	
Total Acc. Deprec. And Deferred Taxes on Investment in Current ISRS		Þ	(460,778)	Þ	(460,778)	Þ	(460,778)	Þ	-	\$	-
TOTAL ISRS NET PLANT ADDITIONS		\$	52,997,724	\$	64,555,067	\$	55,790,414	\$	(8,764,653)	\$	(8,764,653)

## **CALCULATION OF ISRS REVENUE REQUIREMENT**

	MAWC Filed Application		MAWC Updated Position		Staff's Position		Amount of NOL Removed		Total STAFF and MAWC Differences	
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 Capital	\$	5,002,985	\$	6,093,998	\$	5,266,615	\$	(827,383)	\$	(827,383)
Depreciation Expense	\$	662,746	\$	873,085	\$	873,085			\$	-
Property Taxes	\$	2,739,347	\$	2,739,145	\$	2,739,145			\$	-
ISRS Undercollection	\$	-	\$	-	\$	-			\$	-
Revenue Requirement Before Interest Deductibility	\$	8,405,078	\$	9,706,228	\$	8,878,845	\$	(827,383)	\$	(827,383)