

Exhibit No.:
Issue: Net Operating Loss
Witness: Mark L. Oligschlaeger
Sponsoring Party: MoPSC Staff
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MISSOURI PUBLIC SERVICE COMMISSION

COMMISSION STAFF DIVISION

AUDITING DEPARTMENT

REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WO-2019-0184

Jefferson City, Missouri
May 2019

1 A. Yes, there is. An NOL was generated by MAWC for a period of time
2 through the end of 2017. However, it is reasonable to assume that an NOL deferred tax
3 asset was reflected in rate base in MAWC's last general rate case, Case No. WR-2017-0285.
4 That rate case had a true-up cut-off date of December 31, 2017, and all revenue requirement
5 issues were resolved by a *Stipulation and Agreement* filed on March 1, 2018. Under the terms
6 of the *Stipulation and Agreement* no further rate treatment of ISRS eligible costs (including
7 NOL amounts) incurred prior to January 1, 2018 is allowed in subsequent ISRS proceedings.¹
8 For that reason, the only NOL amounts potentially relevant to this case and MAWC's prior
9 ISRS petition would be if any additional NOL amount was generated by MAWC from
10 January 2018 through March 2019, the period of time covered in those proceedings.

11 Q. Has MAWC generated any NOL during the ISRS periods for the current and
12 prior ISRS cases (No. WO-2018-0373)?

13 A. No. As clearly shown in the response to Staff Data Request No. 0004,²
14 the balance of MAWC's NOL deferred tax asset has been declining so far in 2018 and 2019,
15 including the ISRS period in this case. The response also indicates that this reduction is
16 expected to continue until at least the end of 2019. This means that MAWC is expecting to
17 use its prior NOL to offset taxable income in 2018 and 2019, and the Company is not
18 projecting any additional generation of NOL in the aggregate for the ongoing future.

¹ Paragraph 8.b of the *Stipulation and Agreement* states that "All ISRS-eligible investments placed in service beginning January 1, 2018, shall be eligible for the ISRS mechanism in accordance with Section 393.1003.1 RSMo." This provision effectively precludes the inclusion in subsequent ISRS proceedings of costs associated with any otherwise eligible plant investment made prior to January 1, 2018.

² This data request response is attached to the direct testimony of Staff witness Karen Lyons filed in this proceeding as Schedule KL-d2.

1 Q. When a utility is able to use prior amounts of NOL to offset taxable income on
2 a going forward basis, as MAWC projects it can do currently and in the future, what does that
3 mean in relation to tax normalization accounting and ratemaking?

4 A. A utility that is in the position of “using” prior NOLs to offset taxable income
5 by mathematical necessity is able to reflect all of its current accelerated depreciation tax
6 deductions on its tax returns going forward, and as a result receive the full financial benefit of
7 such deductions. Because these benefits are provided to the utility in customer rates through
8 collection of deferred income taxes, the resulting accumulated deferred income tax (“ADIT”)
9 balance must be included in rate base without offset in order to provide ratepayers a return on
10 capital they are actually providing to the utility.

11 Q. In his direct testimony, Mr. Wilde claims that failure to reflect a rate base
12 offset for a hypothetical NOL in this case could lead to an IRS Code tax normalization
13 requirement violation. Do you agree?

14 A. No. Staff has not found any support for this contention in either the IRS Code
15 or in the private letter rulings (“PLRs”) cited by Mr. Wilde.

16 Q. Why do you say the IRS Code does not support MAWC’s position in
17 this case?

18 A. The specific language in the Code addressing the potential impact of NOLCs
19 on tax normalization requirements, included in 26 CFR § 1.167(l)-1-(h) (1) (iii), states
20 as follows:

21 * * * If, however, in respect of any taxable year the use of a method of depreciation
22 other than a subsection (I) method for purposes of determining the taxpayer’s
23 reasonable allowance under section 167(a) **results in a net operating loss**
24 **carryforward (as determined under section 172) to a year succeeding such**
25 **taxable year which would not have arisen (or an increase in such carryforward**
26 **which would not have arisen) had the taxpayer determined his reasonable allowance**

1 under section 167(a) using a subsection (I) method, then the amount and time of the
2 deferral of tax liability shall be taken into account in such appropriate time and
3 manner as is satisfactory to the district director. [Emphasis added.]

4 As shown above, the tax normalization requirements embedded within the IRS Code
5 do state that the existence of NOLs can be a relevant consideration in assessing whether
6 a utility is in compliance with the rules. However, as shown in the highlighted language in
7 the above quote, the IRS Code specifies that NOLs may be relevant for that purpose in
8 two specific situations: first, when a utility is unable to reflect all of its available accelerated
9 depreciation tax deductions on its tax returns during a rate case period, thus creating a new
10 NOL; and, second, when a utility's balance of an already existing NOL deferred tax asset
11 increases due to the utility's continuing inability to reflect all available tax deductions in a rate
12 case period. However, neither situation applies to MAWC during either this particular ISRS
13 period, or the prior ISRS period. So far in 2018 and 2019, MAWC has not generated any new
14 NOL in the aggregate, and as a result its existing NOL balance has been decreasing, not
15 increasing. Since MAWC is not currently generating any additional amount of NOL in
16 aggregate within the relevant timeframes for the present and prior ISRS cases, no violation of
17 the tax normalization requirements associated with NOLs should be assumed to result.

18 Q. On page 7, line 23 through page 8, line 2, Mr. Wilde states that the applicable
19 provisions of the IRS code "seem to make it clear, the taxpayer in applying the tax
20 normalization rules should be concerned with a deduction subject to normalization both
21 causing a delay in the use of an existing NOLC, as well as building a new NOLC in the
22 current period." Does Staff agree?

23 A. No. Based upon a plain reading of the IRS Code, Staff finds no support for the
24 concept that a "delay" in a utility's ability to use prior generated NOL amounts to offset

1 taxable income going forward should be considered as equivalent to an “increase” in NOL
2 that would trigger the IRS Code’s normalization requirements.

3 Q. Why did you say earlier that the PLRs referred to by Mr. Wilde do not support
4 the Company’s position on this issue?

5 A. None of the PLRs attached to Mr. Wilde’s testimony are relevant to MAWC’s
6 current financial and taxable positions. Without exception, all of the PLRs cited by
7 Mr. Wilde address time periods in which the utility in question was generating NOL amounts.
8 Again, MAWC is not currently generating any NOL; it is “using” prior amounts instead
9 to offset taxable income going forward. Mr. Wilde has not provided any citations to PLRs
10 that address tax normalization requirement consequences (if any) of NOLs in the situation in
11 which a utility is using and not generating NOL amounts.

12 In addition, none of the PLRs cited as support for MAWC’s position on this issue by
13 Mr. Wilde in his direct testimony appear to relate to single-issue rate proceedings similar to
14 the ISRS process in Missouri. Instead, the issues in those PLRs appear to relate to either
15 general rate proceedings or “formula rate” proceedings.

16 Q. Mr. Wilde also makes several references in his testimony to the “with
17 and without” method applicable to tax treatment of NOL for utilities which the IRS has
18 allegedly mandated be used for purposes of quantifying the hypothetical NOL deferred tax
19 asset in this proceeding. Does Staff agree that the “with and without” method is an
20 appropriate way to quantify the appropriate amount of NOLs to allocate to single-issue rate
21 elements?

22 A. No. The PLRs attached to Mr. Wilde’s direct testimony make it clear that in
23 each case the “with and without” method discussed within is intended to be used to determine

1 | how much of a utility's generated NOL should be considered attributable to accelerated
2 | depreciation deductions and how much of the NOL should be attributable to other categories
3 | of the utility's tax deductions for purposes of monitoring compliance with the Code.
4 | However, in this proceeding, MAWC is actually proposing to apply a different "with and
5 | without" method for an entirely separate purpose, which is to determine how much of an NOL
6 | should be assigned to a single-issue rate element of ISRS plant additions in lieu of attributing
7 | the NOL to other MAWC cost components not eligible for ISRS rate recovery. None of the
8 | PLRs attached to Mr. Wilde's testimony or otherwise provided to Staff provide any guidance
9 | on how to make assignments of NOL to separate rate elements in single-issue rate
10 | proceedings, and the PLRs certainly do not specify that the "with and without" method must
11 | be used for this purpose.

12 | Q. At pages 19 - 20 of his direct testimony, Mr. Wilde presents a quantification of
13 | an alleged increase in MAWC's NOL balance during the current ISRS period. What does this
14 | calculation show?

15 | A. All that Mr. Wilde demonstrates with this calculation is that MAWC would be
16 | using even more of its NOL to offset taxable income from October 1, 2018, through March
17 | 31, 2019, under the hypothetical scenario that MAWC would have made no ISRS plant
18 | additions during that six-month period. However, in reality, a shortfall between the actual
19 | amounts of NOL available to offset taxable income in a given period compared to the level of
20 | NOL available for that purpose under a different and hypothetical scenario cannot reasonably
21 | be considered to constitute an "increase" in NOL, especially when the overall balance of the
22 | utility's NOL is decreasing. As I previously testified, it is only when an NOL is increasing
23 | that the tax normalization rules come into play for utilities.

1 Q. Do you believe that MAWC's position on NOL ratemaking in this case is
2 consistent with the Missouri statutes authorizing the ISRS rate procedure, as stated by Mr.
3 Wilde at page 8, lines 7 – 10 of his direct testimony?

4 A. No. Section 393.1000, RSMo, authorizes the Commission to set qualifying
5 utility rates on a single-issue basis for costs associated with ISRS eligible plant additions.
6 The costs to be afforded recovery under the ISRS process include actual income tax impacts
7 directly related to eligible plant additions, including the changes in the utility ADIT reserve
8 caused by these additions. There is nothing stated or implied in the ISRS Statute that
9 reasonably can be interpreted as requiring a utility to impute hypothetical tax impacts in
10 setting ISRS rates.

11 Q. Do you believe that MAWC's position on NOL ratemaking in this case is
12 consistent with the intent of and the theory behind the IRS Code tax normalization
13 requirements, as alleged by Mr. Wilde at page 8, lines 12 – 16 of his direct testimony?

14 A. No. As previously stated, Staff perceives that the clear intent behind the tax
15 normalization requirements involving NOLs is that utility customers not receive a reduction
16 to rate base for deferred taxes in the situation in which the utility was not able to timely reflect
17 all of the deductions giving rise to the deferred taxes on its tax return. MAWC's position on
18 NOL recovery in the current and prior ISRS cases, however, would inappropriately reverse
19 that intent by denying a rate base reduction for capital provided by utility customers to
20 utilities in the form of deferred taxes. This result would be squarely inconsistent with proper
21 ratemaking principles and is not mandated in any fashion by the IRS Code.

22 Q. Does this conclude your rebuttal testimony?

23 A. Yes, it does.

