

Exhibit No:
Issues: *Defined Contribution
Plan; Income Taxes*
Witness: *Kofi A. Boateng*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Rebuttal Testimony*
Case No. *WR-2015-0301*
Date Testimony Prepared: *February 11, 2016*

MISSOURI PUBLIC SERVICE COMMISSION

COMMISSION STAFF DIVISION

AUDITING DEPARTMENT

REBUTTAL TESTIMONY

OF

KOFI A. BOATENG

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2015-0301

Jefferson City, Missouri
February 2016

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INCOME TAX..... 2

DEFINED CONTRIBUTION PLAN 5

1 **REBUTTAL TESTIMONY**

2 **OF**

3 **KOFI A. BOATENG**

4 **MISSOURI-AMERICAN WATER COMPANY**

5 **CASE NO. WR-2015-0301**

6 Q. Please state your name and business address.

7 A. Kofi A. Boateng, 111 N. 7th Street, Suite 105, St. Louis, MO 63102.

8 Q. By whom are you employed and in what capacity?

9 A. I am a Utility Regulatory Auditor IV with the Missouri Public Service
10 Commission (“Commission”).

11 Q. Are you the same Kofi A. Boateng that was responsible for certain sections of
12 the Staff’s Revenue Requirement Cost of Service Report (“Staff Report”) filed in this case for
13 Missouri-American Water Company (MAWC or “Company”) on December 23, 2015?

14 A. Yes, I am.

15 Q. What is the purpose of your rebuttal testimony?

16 A. The purpose of my testimony is first to respond to the direct testimony of The
17 Office of the Public Counsel (“OPC”) witness Ralph C. Smith regarding OPC’s proposed
18 adjustments to Income Tax for the Domestic Production Activities Deduction (DPAD) and for
19 bonus tax depreciation. Secondly, I explain income tax or revenue conversion factor, which is
20 calculated as an addition to revenue requirement. Finally, I will address Staff’s adjustment to
21 include an appropriate level for MAWC’s defined contribution pension plan which was
22 inadvertently omitted from Staff’s cost of service calculation.

1 **INCOME TAX**

2 Q. Have you reviewed the direct testimony of OPC witness Smith as it relates to
3 the income tax calculation for MAWC in this rate proceeding?

4 A. Yes, I have. OPC witness Smith discusses two specific issues related to
5 income tax in his direct testimony. First, Mr. Smith at pages 33 through 41 addresses why, in
6 his opinion, MAWC should take advantage of the Domestic Production Activities Deduction
7 under Section 199 of the *Internal Revenue Code* to reduce the Company's income tax burden.
8 Secondly, Mr. Smith expresses his concerns over bonus tax depreciation that MAWC failed to
9 deduct in its tax returns for prior years. This issue is addressed at pages 41 through 46, in his
10 direct testimony.

11 Q. What is the domestic production activities deduction?

12 A. This deduction, sometimes also referred to as the "domestic manufacturing
13 deduction," "U.S. production activities deduction" or "domestic production deduction," was
14 instituted by the American Jobs Creation Act of 2004, effective for tax years beginning after
15 2004 under Internal Revenue Code (IRC) section 199. While section 199 comes with a
16 complex set of rules, it nonetheless represents a valuable tax benefit for businesses that
17 perform domestic manufacturing and certain other production activities. The deduction
18 started at 3% in 2005 – 2006 of qualified costs, then increased to 6% for tax years 2007 -
19 2009, and 9% for 2010 and following years. The amount of the deduction for any tax year
20 may not exceed the taxpayer's taxable income or, in the case of individuals, adjusted gross
21 income. The amount of the deduction is limited to 50% of the taxpayer's Form W-2 wages
22 attributable to domestic production gross receipts.

23 Q. What is Staff's position regarding OPC witness Smith's testimony that
24 MAWC's income tax obligation should be reduced by the domestic production deduction?

Rebuttal Testimony of
Kofi A. Boateng

1 A. Staff supports Mr. Smith’s position with regard to the domestic production
2 deduction as was advocated for in detail in Mr. Smith’s direct testimony in this rate case.
3 This is an income tax deduction that MAWC and other utilities operating in Missouri should
4 be taking in order to help keep costs to a minimum.

5 Q. What other issue did OPC witness Smith discuss that you will address as part
6 of your rebuttal testimony?

7 A. OPC witness Smith also discussed in his direct testimony the decision by
8 MAWC’s parent company American Water Works Company, Inc. (“AWW”) to not take a
9 bonus tax depreciation deduction on account of the parent company’s consolidated net
10 operating loss carryforwards and charitable deduction carryforwards. At pages 41 through 46
11 of his testimony, Mr. Smith argued that MAWC’s parent company made a tactical decision to
12 not take bonus tax depreciation in the tax years of 2011 and 2013. He states a belief that
13 taking this deduction would have reduced MAWC’s rate base, and also increased its
14 accumulated deferred income tax (ADIT) balance that in turn would eventually reduce
15 MAWC’s revenue requirement.

16 Q. What is Staff’s position with regard to OPC witness Smith’s testimony arguing
17 that MAWC’s parent company should have taken advantage of the bonus tax depreciation in
18 those years that AWW opted not to take them?

19 A. Staff agrees with OPC’s position as outlined in detail in Mr. Smith’s direct
20 testimony and believes that it would have been a benefit to MAWC’s ratepayers if MAWC
21 and its parent company had taken the bonus depreciation deduction in the tax years of 2011
22 and 2013. Like OPC, Staff is not making any adjustment at this time to recognize the impact
23 of the failure of MAWC and its parent company AWW to take the bonus depreciation

Rebuttal Testimony of
Kofi A. Boateng

1 deduction. In the next MAWC rate case, Staff may perform adjustments to impute a generic
2 rate base offset balance for loss of the ADIT that would have resulted had MAWC
3 appropriately taken advantage of the bonus tax depreciation in prior years. Alternatively,
4 Staff may propose to include a parent company tax deduction in future rate cases to address
5 the fact that the parent company made these decisions without regard for how it might impact
6 MAWC and its ratepayers.

7 Q. What additional issue regarding income tax do you want to address?

8 A. At this time, I would like to explain the income tax factor-up calculation,
9 which was not previously discussed in my direct testimony. Once the expenses, rate base and
10 rate of return amounts affecting a utility's revenue requirement are determined, another
11 adjustment is needed to account for additional income taxes. This adjustment is calculated by
12 multiplying an income tax factor-up against the difference that exists between the net
13 operating income from existing rates and the level of net operating income required.
14 When this difference is factored-up for income taxes, this amount represents the incremental
15 change in MAWC's rate revenues required to cover all reasonable and prudently incurred
16 operating costs and to provide a fair return on investment. The income tax factor-up is
17 determined through the use of the following formula: $(1/1 - \text{effective tax rate})$. The effective
18 tax rate is the overall combined current state and federal income tax rates. The income tax
19 factor-up is then multiplied by the operating income deficiency to determine the total amount
20 of revenue required for the operating income deficiency and the associated increase in income
21 tax expense.

22 Q. Have you calculated the appropriate income tax factor-up in this rate case
23 proceeding?

Rebuttal Testimony of
Kofi A. Boateng

1 A. Yes, I have. Please see Schedule KAB-r1, attached to this rebuttal testimony.
2 Based upon effective income tax rate of 38.3886%, Staff recommends an appropriate income
3 tax factor-up conversion factor of 1.6231, to be applied to the operating income deficiency.

4 Q. In your calculation of the recommended tax gross-up conversion factor to
5 apply to the operating income deficiency, did you include any “gross-up factor” for
6 uncollectible accounts?

7 A. No, I did not. Staff does not agree with MAWC’s proposal to factor up the net
8 operating income deficiency for anticipated uncollectibles expense that MAWC suggests will
9 occur as a result of their proposed rate increase. Please refer to Staff witness Erin M. Carle’s
10 rebuttal testimony for a complete discussion of this issue.

11 **DEFINED CONTRIBUTION PLAN**

12 Q. Is Staff proposing an adjustment to MAWC’s defined contribution plan (DCP)
13 pension expense?

14 A. Yes. In my direct testimony, I indicated Staff has reflected MAWC costs
15 relating to DCP in its cost of service calculation; however, it was later realized that no such
16 adjustment was included in the Staff’s Direct Accounting Schedules. Therefore, I am now
17 proposing an adjustment of \$311,368 to bring DCP’s test year level of \$952,644 to an
18 annualized level of \$1,264,012.

19 Q. Does this conclude your rebuttal testimony?

20 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water)
Company's Request for Authority to Implement)
a General Rate Increase for Water and Sewer)
Service Provided in Missouri Service Areas) Case No. WR-2015-0301

AFFIDAVIT OF KOFI A. BOATENG, CPA, CIA

STATE OF MISSOURI)
) ss.
COUNTY OF ST. LOUIS)

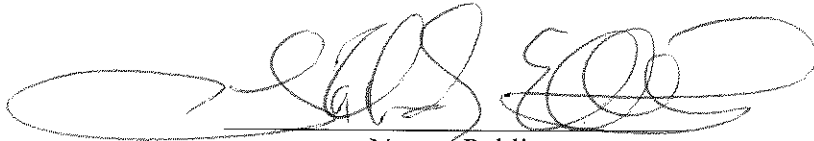
COMES NOW KOFI A. BOATENG, CPA, CIA and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing REBUTTAL TESTIMONY; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.


KOFI A. BOATENG, CPA, CIA

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the ^{City} County of St. Louis, State of Missouri, at my office in St. Louis, on this 10th day of February, 2016.



Notary Public
LARHONDA ELLIS
Notary Public - Notary Seal
State of Missouri
Commissioned for St. Louis City
My Commission Expires: March 08, 2018
Commission Number: 14779868

Missouri-American Water Company
Case Nos. WR-2015-0301 & SR-2015-0302
Revenue/Tax Conversion Factor
For the Test Year Ending December 31, 2014

| <u>Line No.</u> | <u>Description</u> [A] | <u>Rate</u> [B] | <u>Per Staff Without Bad Debts</u> [D] |
|-----------------|---|--------------------|---|
| 1 | Revenue | | 1,000 |
| 2 | State Income Tax | 5.2133% | 52.1327 |
| 3 | Federal Income Tax | 33.1754% | 331.7536 |
| 4 | Total Taxes and Expenses | | 383.8863 |
| 5 | Net Amount | | 616.1137 |
| 6 | Revenue Conversion Factor (Line 1 / Line 5) | | <u><u>1.6231</u></u> |