LAW OFFICES
HAWKINS, BRYDON & SWEARENGEN
PROFESSIONAL CORPORATION
312 EAST CAPITOL AVENUE
P.O. BOX 456
JEFFERSON CITY, MISSOURI 65102-0456

ROBERT L. HAWKINS, JR.
DAVID V.G. BRYDON
JAMES C. SWEARENGEN
WILLIAM R. ENGLAND, III
ROBERT L. HAWKINS, III
JOHNNY K. RICHARDSON
STEPHEN G. NEWMAN
MARK W. COMLEY
GARY W. DUFFY
VICKI J. GOLDAMMER
PAUL A. BOUDREAU

AREA CODE 314
TELEPHONE 635-7166
TELECOPIER 634-7431

December 15, 1986

Mr. Dan Redel, Acting Secretary
Missouri Public Service Commission
P. O. Box 360
Jefferson City, Missouri 65102

Re: Case No. AO-87-48, Tax Reform Act

Dear Mr. Redel:

Enclosed for filing with the Commission, please find three copies of the following:

1. Continental Telephone Company of Missouri's response to the Order Initiating Investigation issued November 3, 1986 and

2. Contel System of Missouri, Inc.'s response to the Order Initiating Investigation issued November 3, 1986.

Please note that in discussions with representatives of the Staff late last week, it was determined that although Webster County Telephone Company did not meet the $2 million a year annual revenue criteria set forth in the Commission's Order of November 3, 1986, that information regarding Webster County Telephone Company would nevertheless be provided. Inasmuch as the Company, up until late last week, had concentrated all its efforts in preparing the responses for Continental Telephone Company of Missouri and Contel System of Missouri, Inc., it is respectfully requested that Webster County Telephone Company be given an extension of time until December 19, 1986, within which to file information as requested by the Commission in its Order of November 3, 1986.

Would you please see that these filings are brought to the attention of the appropriate Commission personnel as well as the request for extension on behalf of Webster County Telephone Company. I thank you in advance for your cooperation in this matter.

FILED

DEC 15 1986

PUBLIC SERVICE COMMISSION

Sincerely,

WREngland III

W. R. England, III

WRE/da
Enclosures
cc: Office of Public Counsel

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

Continental Telephone Company of Missouri's Response to the Order Initiating Investigation Issued November 3, 1986	))))	Case No. AO-87-48 Effects of 1986 Federal Tax Reform

In response to the above referenced Order Initiating Investigation issued November 3, 1986, Continental Telephone Company of Missouri (the Company) submits the following information per the guidelines provided in this Order.

The Company has made preliminary estimates of the effects that the Tax Reform Act of 1986 will have on its current income tax payment, deferred tax accruals and revenue requirements. The Company made these estimates based upon its December 31, 1985 financial data which was the test period used in the Company's last rate case (Case No. TR-86-55). The attached Schedules 1, 2 and 3 reflect the respective revenue requirement, rate base and income statement of the Company at 12/31/85 prior to the adjustments needed to reflect the Tax Reform Act. Schedule 4 details the change in the current tax payment, income tax provision (including deferred taxes) and revenue requirement. As Schedule 4 indicates, the current State and Federal tax payment (columns b and c) on a jurisdictional basis for 1985 is approximately $656,000 using the current 46% tax rate and deductions allowable under the current tax law. Keeping the tax rate at 46% but taking into consideration the remaining provisions of the new tax law (elimination of investment tax credit, bad debts accrual and the disallowance of the current tax deduction for interest, taxes and pensions

FILED

DEC 15 1986

PUBLIC SERVICE COMMISSION

21.

capitalized), this current payment, shown in columns d and e, rises to approximately $3,206,000. This reflects an increase in current taxes payable of approximately $2,550,000. The related deferred tax expenses decreased by approximately $2,173,000. The major reason for the swing between current and deferred taxes is due to the elimination of the investment tax credit. As this comparison indicates, total Federal and State income tax provisions under the new tax law would increase approximately $377,000 if the tax rate remained constant at 46%.

Schedule 4, columns f and g, provides the tax provision change directly applicable to the rate change from 46% to 40%. The excess deferred taxes applicable to accelerated depreciation that result from this rate change are addressed in this comparison also. The new tax law requires this excess be normalized and restored to income over a period of years using the average rate assumption method. Using this methodology and the blended effective tax rate of 40%, the Company estimates on line 29 that approximately $215,000 of excess jurisdictional deferred taxes would be credited to income (see Schedule 5). The amount credited to income in future years will fluctuate significantly depending on the actual reversal of the timing differences. The total decrease in the tax provision including the excess tax income credit is approximately $622,000. The resulting revenue impact of the new tax laws and the blended 40% federal tax rate is approximately $1,070,000.

Schedule 4, columns h and i, provides the further tax provision change in the years subsequent to 1987 when the full impact of the rate change from 46% to 34% will be effective rather than the blended 1987 effect shown in columns f and g. The tax decrease would be approximately $1,616,500 in 1988. The resulting revenue impact would be approximately $2,535,000. The total income tax provision will [illegible] initially (as detailed on Schedule 4) and therefore initially there will be a benefit to both the Company's customers and its shareholders. In the long term, however, it appears that the changes required by this law will ultimately increase the tax liability of the Company and work to the detriment of both the customers and the shareholders. The major consideration being the elimination of investment credit and its subsequent amortization. As a result of the elimination of investment tax credit effective January 1, 1986, the Company estimates that it will forego the following amounts of investment tax credit during the years 1986 through 1988:

Year	Estimated Lost Investment Tax Credit
1986	$2,435,000
1987	2,872,000
1988	2,619,000

Loss of this credit will result in foregone amortization and have the effect of increasing future periods income tax expense in the following amounts:

Investment Credit Year	Estimated Reduced Amortization 1986	1987	1988
1986	$83,100	$166,200	$166,200
1987	-	98,000	196,000
1988	-	-	89,400
	$83,100	$264,100	$451,600
Jurisdictional Factor	.7439	.7439	.7439
Increased Jursidictional Tax Expense	$61,800	$196,500	$336,000

Projected amortization computed using the 1985 composite rate of 6.8251%

calculated per the rate case.

Since the full effects of the provisions of the new law will not be felt for several years, the Company feels that the Commission should concentrate its efforts on those changes which will become effective during the calendar year 1987. The Commission should also consider that changes from this Act are not absolute since members of Congress have already begun discussing a tax increase during the next session of Congress to follow this tax reform. Any procedures which this Commission adopts as a result of this proceeding should envision applicability to further changes (either positive or negative) which may occur during the next several years.

The Company feels that the Commission should take further time to study the effects of this recently enacted legislation. The blended 40% tax rate which will be effective in 1987 is derived through a rate change from 46% to 34% effective July 1, 1987. Therefore, the Company feels that any action taken by this Commission need not be effective prior to July 1, 1987. It is the Company's position that this Commission should consider potential actions which it could take, while taking advantage of the time between now and July, 1987 for further study.

The Company is greatly concerned with the effect that several key issues, whose impact cannot be measured at this early date, will have on the Company. Preliminary review indicates that the Alternative Minimum Tax (AMT) will not impact the Company in 1987 or 1988. However, in future years the potential increase in tax expense related to AMT may affect the Company's operations. The reduction in internally generated funds may place the Company in a position which requires further long-term debt commitments. Any resulting issue of additional long-term debt will have the effect of lowering its equity ratio which could potentially require an increased return on equity and ultimately affect the Company's required rate of return. As indicated on Schedule 6, the impact of tax reform is not specifically attributable to the local jurisdiction. Of the estimated $2,535,000 revenue requirement impact from the Tax Reform Act, $968,000 is attributable to the local jurisdiction while $1,567,000 is attributable to the intrastate interLATA and intraLATA jurisdictions. Current or proposed impacts of the Tax Reform Act on the toll pools or access charges must be determined prior to a determination of the ultimate effect on local operations.

The Company believes that the Commission should explore through an interim order in this docket the parameters within which it would consider individual company proposals to effectuate any changes required by the new law. These parameters might include such items as test period to be used or types of adjustments which might be considered. In doing so, it should establish a deadline for input in those parameters which would be considered by the Commission and subsequently for individual companies to file plans with the Commission which will allow the Commission time to consider these proposals prior to a July 1, 1987 effective date. Since individual company situations vary, even within the same industry, such a proposal would allow companies to propose plans which deal specifically with the needs of their customer and their shareholders.

The Company is considering several alternatives to deal with these law changes including, but not limited to:

1. Potential capital-recovery issues.

2. Potential shift of NTS cost to end user.

3. Potential for implementing optional calling plans for the St. Charles area.

4. Potential for implementing optional local measured service on a statewide basis.

5. Potential reductions in local service rates.

The Company believes that items such as those enumerated above could be considered as part of this proceeding dealing with the Tax Reform Act of 1986.

Finally, it is the Company's position that any reduction in rates that might take place as a result of this proceeding be predicated upon the revenue requirement determined in the Company's most recent rate case upon which the existing level of rates was established, adjusted only for these tax changes.

The Company wishes to emphasize that the information provided herein is based on 1985 data, estimates in many cases, and our preliminary interpretation of the Tax Reform Act. While the Commission feels it is reasonable to assume that utilities in Missouri have preliminary estimates of the impact of tax reform, the information included herein should be considered in that light and regarded only as estimates. As additional information concerning the tax law and 1986 information becomes available, these preliminary estimates must be updated.

CONTINENTAL TELEPHONE COMPANY OF MISSOURI

By: WmMEdwards

William M. Edwards, III
Vice President

CTC OF MISSOURI

Stipulated Revenue Requirement

Case No. TR-86-55

Line No.	Description (a)	Amount (b)
1.	Jurisdictional Rate Base	$136,355,898
2.	Authorized Rate of Return	10.55%
3.	Net Operating Income Requirement	$ 14,385,547

CTC OF MISSOURI

Stipulated Rate Base

Case No. TR-86-55

Line No.	Description (a)	12/31/85 Jurisdictional Amounts (b)
1.	Total Plant in Service	$213,414,307
2.	Depreciation Reserve	(47,141,881)

3.	Net Plant in Service	$166,272,426
	Add	
4.	Cash Working Capital	$ (3,534,217)
5.	Material & Supply	1,166,872
6.	Prepayments	97,573
7.	RDS System	225,336
	Less	
8.	Income Tax Offset	42,039
9.	Interest Expense Offset	474,532
10.	Customer Deposits	1,304,357
11.	Customer Advances for Construction	11,396
12.	Deferred Income Taxes	25,797,879
13.	Deferred Vacation Bank	241,889

14.	Total Rate Base	$136,355,898
		=============

CTC OF MISSOURI

Stipulated Income Statement

Case No. TR-86-55

Line No.	Description	12/31/85 Jurisdictional Amounts
	Operating Revenues	
1.	Local Service Revenues	$25,419,754
2.	Toll Service Revenues	43,361,146
3.	Miscellaneous Revenues	4,232,912
4.	Uncollectible Revenues	(459,686)
5.	Total Operating Revenues	$72,554,126
	Operating Expenses	
6.	Maintenance Expense	$14,255,032
7.	Traffic Expense	4,335,313
8.	Commercial Expense	5,362,761
9.	General Office Expense	6,453,495
10.	Other Operating Expense	6,231,774
11.	Depreciation & Amortization Expense	13,608,579
12.	Taxes Other than Income Taxes	2,510,730
13.	Total Operating Expenses	$52,757,684
14.	Net Income Before Taxes	$19,796,442
15.	Current Income Taxes	$ 655,922
	Deferred Income Tax	
16.	Deferred ITC Provision	$ 2,173,437
17.	Amortization of ITC	(785,990)
18.	Deferred Income Tax Expense	3,380,403
19.	Deferred Income Tax Amortization	(12,877)
20.	Total Income Taxes	$ 5,410,895
21.	Net Operating Income	$14,385,547

CTC OF MISSOURI

Schedule 4

Revenue Requirement Impact of Federal Tax Changes to 1985 Jurisdictional Operations

Line No.	Description	FIT @ 46% Per TR-86-55		Impact of Tax Changes FIT Remaining @ 46%		Impact of Tax Changes FIT Changing to 40%		Impact of Tax Changes FIT Changing to 34%	
		State	Federal	State	Federal	State	Federal	State	Federal
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
1.	Net Income	$14,385,547	$14,385,547	$14,009,237	$14,009,237	$15,007,889	$15,007,889	$16,002,076	$16,002,076
2.	Current SIT	272,374	272,374	186,537	186,537	206,629	206,629	226,598	226,598
3.	Current FIT	383,548	383,548	3,019,132	3,019,132	2,402,562	2,402,562	1,788,446	1,788,446
4.	Deferred SIT	196,460	196,460	196,460	196,460	217,815	217,815	239,169	239,169
5.	Deferred FIT	3,183,943	3,183,943	3,183,943	3,183,943	2,760,414	2,760,414	2,339,020	2,339,020
6.	Deferred Invest. Tax Credit	2,173,437	2,173,437	-	-	-	-	-	-
7.	Amortization of ITC	(798,867)	(798,867)	(798,867)	(798,867)	(798,867)	(798,867)	(798,867)	(798,867)
8.	Total Taxes	$ 5,410,895	$ 5,410,895	$ 5,787,205	$ 5,787,205	$ 4,788,553	$ 4,788,553	$ 3,794,366	$ 3,794,366
9.	Net Operating Inc. Before Tax	$19,796,442	$19,796,442	$19,796,442	$19,796,442	$19,796,442	$19,796,442	$19,796,442	$19,796,442
	Deductions								
10.	Fixed Charges	6,711,913	6,711,913	6,711,913	6,711,913	6,711,913	6,711,913	6,711,913	6,711,913
11.	Capitalized Interest - TPUC	28,557	28,557	-	-	-	-	-	-
12.	Diff. Betw. Tax S/L and Book	(700,008)	(700,008)	(700,008)	(700,008)	(700,008)	(700,008)	(700,008)	(700,008)
13.	Payroll Taxes Capitalized	209,405	209,405	-	-	-	-	-	-
14.	Pensions Capitalized	223,378	223,378	-	-	-	-	-	-
15.	Property Taxes Capitalized	1,169	1,169	-	-	-	-	-	-
16.	Sales Tax Capitalized	389,051	389,051	-	-	-	-	-	-
17.	Amortization of RTB	(16,197)	(16,197)	(16,197)	(16,197)	(16,197)	(16,197)	(16,197)	(16,197)
18.	Excess Tax Depreciation	6,773,472	6,773,472	6,773,472	6,773,472	6,773,472	6,773,472	6,773,472	6,773,472
19.	Removal Costs	344,666	344,666	344,666	344,666	344,666	344,666	344,666	344,666
20.	1/4 of 12/85 Uncollectible Res.	-	-	(67,271)	(67,271)	(67,271)	(67,271)	(67,271)	(67,271)
21.	Total Deductions	$13,965,406	$13,965,406	$13,046,575	$13,046,575	$13,046,575	$13,046,575	$13,046,575	$13,046,575
22.	Taxable Income	$ 5,831,036	$ 5,831,036	$ 6,749,867	$ 6,749,867	$ 6,749,867	$ 6,749,867	$ 6,749,867	$ 6,749,867
23.	Less Curr. Fed. Provision	383,548	-	3,019,132	-	2,617,295	-	2,217,911	-
24.	Less Curr. State Provision	-	272,374	-	186,537	-	206,629	-	226,598
25.	Tax Base	$ 5,447,488	$ 5,558,662	$ 3,730.735	$ 6,563,330	$ 4,132,572	$ 6,543,238	$ 4,531,956	$ 6,523,269
26.	Tax Rate	.05	.46	.05	.46	.05	.40	.05	.34
27.	Tax Provision	$ 272,374	$ 2,556,985	$ 186,537	$ 3,019,132	$ 206,629	$ 2,617,295	$ 226,598	$ 2,217,911
28.	Less Inv. Tax Credit	-	(2,173,437)	-	-	-	-	-	-
29.	Less Excess Def. Tax/Accl. Dep.	-	-	-	-	-	(214,733)	-	(429,465)
30.	Current Tax Provision	$ 272,374	$ 383,548	$ 186,537	$ 3,019,132	$ 206,629	$ 2,402,562	$ 226,598	$ 1,788,446
31.	Incr. (Decr.) Current Tax Exp.				$ 2,549,747		$ (596,478)		$ (594,147)
32.	Incr. (Decr.) Deferred Tax Exp.				(2,173,437)		(402,174)		(400,040)
33.	Total Increase (Decrease) Tax Expense				$ 376,310		$ (998,652)		$ (994,187)
34.	Cumulative Increase (Decrease) to Income				(376,310)		622,342		1,616,529
35.	Revenue Conversion Factor				.5251		.5816		.6378
36.	Cumulative Revenue Impact				$ (716,644)		$ 1,070,052		$ 2,534,539

CTC OF MISSOURI

Excess Deferred Tax Adjustment Applicable to Accelerated Depreciation

Line No.	Description (a)	Fed. Rate From 46% to 40% (b)	Fed. Rate From 46% to 34% (c)
1.	Estimated 1987 Book Over Tax Provision	$4,831,097	$4,831,097
2.	Average Rate Assumption Method (46% - 40%)	.06	.12
3.	Total Company Excess Taxes	$ 289,866	$ 579,732
4.	Jurisdictional Factor	74.08%	74.08%
5.	Jurisdictional Excess Tax	$ 214,733	$ 429,465

CONTINENTAL TELEPHONE COMPANY OF MISSOURI

Estimated Change in 1985 Revenue Requirement Resulting from Tax Change

Line No.	Description (a)	Local (b)	Intrastate IntraLATA (c)	Intrastate InterLATA (d)	Total Intrastate (e)
1.	NOI Before Tax Change	$ 5,625,590	$ 6,711,033	$ 2,048,924	$ 14,385,547
2.	NOI - New Tax Law @ 34%	6,242,915	7,476,529	2,282,632	16,002,076
3.	Increase in NOI	617,325	765,496	233,708	$ 1,616,529
4.	Revenue Conversion Factor	.6378	.6378	.6378	.6378
5.	Change in Revenue Requirement	$ 967,898	$ 1,200,213	$ 366,428	$ 2,534,539

Schedule 6