

Exhibit No.:
Issues: Income Taxes
Witness: Carl R. Meyers
Exhibit Type: Rebuttal
Sponsoring Party: Missouri-American Water
Company
Case No.: WR-2015-0301
SR-2015-0302
Date: February 11, 2016

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2015-0301
CASE NO. WR-2015-0302**

REBUTTAL TESTIMONY

OF

CARL R. MEYERS

ON BEHALF OF

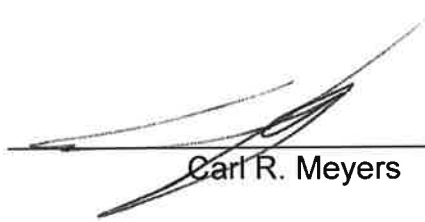
MISSOURI-AMERICAN WATER COMPANY

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

IN THE MATTER OF MISSOURI-AMERICAN)	
WATER COMPANY FOR AUTHORITY TO)	
FILE TARIFFS REFLECTING INCREASED)	CASE NO. WR-2015-0301
RATES FOR WATER AND SEWER)	CASE NO. SR-2015-0302
SERVICE)	

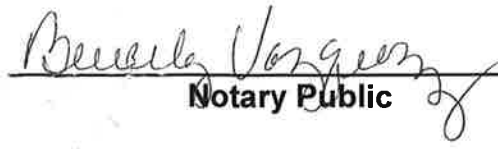
AFFIDAVIT OF CARL R. MEYERS

Carl R. Meyers, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Rebuttal Testimony of Carl R. Meyers"; that said testimony was prepared by him and/or under his direction and supervision; that if inquiries were made as to the facts in said testimony, he would respond as therein set forth; and that the aforesaid testimony is true and correct to the best of his knowledge.



Carl R. Meyers

State of New Jersey
County of Camden
SUBSCRIBED and sworn to
Before me this 6 day of February 2016.



Notary Public

My commission expires:

**REBUTTAL TESTIMONY
CARL R. MEYERS
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2015-0301
CASE NO. WR-2015-0302**

TABLE OF CONTENTS

I.	Introduction.....	1
II.	DPAD.....	2
III.	Deferred Income Tax.....	5

REBUTTAL TESTIMONY

CARL R. MEYERS

I. INTRODUCTION

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

My name is Carl R. Meyers and my business address is 131 Woodcrest Road, Cherry Hill, New Jersey 08003.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by American Water Works Service Company, Inc. (“Service Company”) as the Director of Income Tax. The Service Company is a subsidiary of American Water Works Company, Inc. (“American Water”) that provides support services to American Water’s subsidiaries, including Missouri-American Water Company, Inc. (“Missouri American”, “MAWC” or the “Company”).

Q. HAVE YOU PREVIOUSLY TESTIFIED IN THIS CASE?

A. Yes. I have submitted Direct Testimony in this proceeding.

Q. MR. MEYER, WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to The Office of Public Counsel (“OPC”) witness Ralph Smith’s testimony concerning the imputation of a Domestic Production Activities Deduction (DPAD) in calculating an income tax expense for the Company. In addition, I will address what I believe to be an error in Staff’s deferred income tax calculation as it relates to Contributions in Aid of Construction (CAIC).

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23

II. DPAD

Q. PLEASE EXPLAIN YOUR ISSUES WITH IMPUTTING THE DPAD.

A. Mr. Smith correctly notes (p.33) that the DPAD (also referred to as an Internal Revenue Code §199 deduction) is a tax break for businesses that perform domestic manufacturing and production activities and was established by the American Jobs Creation Act of 2004 in order to spur investment in domestic manufacturing facilities. He also notes correctly (p. 34) that “MAWC participates in the AWWC consolidated federal income tax return [and] the tax position of AWWC prevents the consolidated entity from claiming the §199 deduction on the consolidated federal income tax return.” This is because American Water files a consolidated federal income tax return in which it currently utilizes net operating loss carryforwards which prevents American Water from taking advantage of the DPAD. Mr. Smith claims, however, that because MAWC’s taxes for ratemaking are computed on a stand-alone basis, it is appropriate to impute to it the fictional DPAD that Mr. Smith concedes is not recognized on the consolidated return.

Q. DO YOU AGREE WITH OPC’S IMPUTATION OF THE DPAD TO MAWC?

A. No, I don’t. First, I would point out that the intent of the DPAD was to free up tax dollars that could be used for investment. As I pointed out, however, the DPAD cannot be taken on the consolidated tax return so there are no tax dollars freed for investment. By imputing the fictional DPAD as Mr. Smith does, the cost is being placed upon the investors to the benefit of the ratepayers. In addition, MAWC has contributed to the generation of the consolidated net operating loss carryforward, based on its own prior

1 years losses, to negate its proposed future income tax liability calculated on a separate
2 company (i.e., stand alone) basis in the case. The federal income tax calculation in this
3 case, however, does not account for net operating loss utilization.
4

5 **Q. DOES MR. SMITH EXPLAIN WHY HE IS PROPOSING TO IMPUTE DPAD TO**
6 **MAWC.**

7 A. Yes. Mr. Smith is not happy with the fact that American Water did not elect to take
8 bonus depreciation on its tax return. Consequently, Mr. Smith is proposing to impute the
9 DPAD because bonus depreciation cannot be imputed per the Internal Revenue Code. In
10 fact, he concedes that “reflecting the impact of the DPAD on a separate return basis for
11 MAWC can help alleviate some of the adverse impacts on MAWC's ratepayers, such as
12 the parent company's decision to not have MAWC claim 2011 or 2013 bonus tax
13 depreciation.” He states that the Parent Company’s decisions regarding opting out of
14 bonus depreciation, made only at the consolidated level, has only a detrimental effect on
15 MAWC customers and the DPAD would alleviate that detriment. Before I explain why
16 he is mistaken about American Water’s decision on taking bonus depreciation, I would
17 point out that Mr. Smith appears to be violating the IRC’s normalization procedures by
18 penalizing MAWC for not taking bonus depreciation by imputing a DPAD deduction.
19

20 **Q. PLEASE EXPLAIN WHAT YOU MEAN BY THIS.**

21 A. Mr. Smith recognizes that the Commission cannot impute the effects of taking bonus
22 depreciation without risking the loss of the benefits of accelerated depreciation. He states
23 (p. 45):

1 If the Commission were to impute MAWC's bonus tax
2 depreciation for tax years 2011 and 2013, my
3 understanding is that such imputation would violate tax
4 normalization requirements and would result in MAWC
5 losing its ability to use accelerated tax depreciation for
6 federal income tax purposes. Discontinuing the Company's
7 ability to use accelerated tax depreciation, could thus result
8 in MAWC prospectively having a substantially higher rate
9 base in future rate cases, other things being equal.

10
11 Mr. Smith declined to impute bonus depreciation to MAWC because the effect would be
12 to impermissibly pass the benefits that bonus depreciation provides on to MAWC's
13 ratepayers without the Company ever receiving the benefits of that accelerated
14 depreciation and thereby violate the IRS regulations. In the same vein, however, imputing
15 the DPAD to MAWC as a penalty for its failure to elect bonus depreciation would result
16 in lower rates to the Company's ratepayers, effectively passing on a benefit to ratepayers
17 greater than the benefit realized from bonus depreciation. Under federal regulations, the
18 action of reducing rates in this manner appears to be an indirect normalization violation.
19 An indirect normalization violation is subject to the same sanction as a direct violation.

20
21 **Q. PLEASE EXPLAIN THE POSSIBLE EFFECTS OF HAVING TAKEN BONUS**
22 **DEPRECIATION IN 2011 AND 2013 AND WHY AMERICAN WATER'S**
23 **DECISION WAS APPROPRIATE.**

24 A. The Internal Revenue Code states that a company has the option to elect or not elect
25 bonus depreciation. This allows a Company to manage the effects of the deduction on its
26 whole financial statements and does not force a Company to take the deduction and suffer
27 the negative effects of the action. AWW decided to opt out of taking the bonus
28 depreciation deduction in 2011 because, at the time, the Company believed it would lose

1 some of its net operating loss carryforwards, of which MAWC has a piece. The effect
2 would be increased income tax expense for the portion of the net operating loss lost.
3 MAWC would have had an increased income tax expense, too, which would have been
4 included in recovery of its cost of service. A similar issue occurred in 2013 with AWW's
5 charitable contribution carryforward, of which MAWC has a piece. Taking bonus
6 depreciation would have caused the Company to increase income tax expense for the
7 contribution carryforward piece lost. While the Internal Revenue Code does allow
8 flexibility to opt in and out of bonus depreciation at the legal entity level, having MAWC
9 opt in would not have enough effect on the consolidated group to mitigate the reasons for
10 opting out in the first place.

11 **III. DEFERRED INCOME TAX**

12 **Q. PLEASE EXPLAIN YOUR ISSUES WITH THE STAFF'S DEFERRED INCOME**
13 **TAX CALCULATION.**

14 **A.** The deferred tax effect of the non-taxable portion of the Contributions in Aid of
15 Construction is being duplicated. When the Company calculates tax depreciation, it starts
16 with book basis in the assets and excludes non-taxable contributions and advances to
17 arrive at tax basis and then calculates tax depreciation based on the tax basis. Staff's
18 calculation is picking up this piece again in the Contribution in Aid of Construction line.
19 This line should just be the taxable portion of the contributions and advances. Including
20 the non-taxable portion in the deferred tax calculation is duplicative and overstates the
21 amount of deferred taxes that Staff deducts from rate base.
22
23

1 Q. **DOES THIS CONCLUDE YOUR TESTIMONY?**

2 A. Yes, it does.