

Exhibit No.:
Issues: Overview of Changes to MAWC's
Federal Tax Expense and
Accumulated Deferred Income Taxes
Witness: John R. Wilde
Exhibit Type: Rebuttal-Revenue Requirement
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2017-0285
SR-2017-0286
Date: January 17, 2018

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2017-0285
CASE NO. SR-2017-0286

REBUTTAL TESTIMONY
REVENUE REQUIREMENT

OF

JOHN R. WILDE

ON BEHALF OF

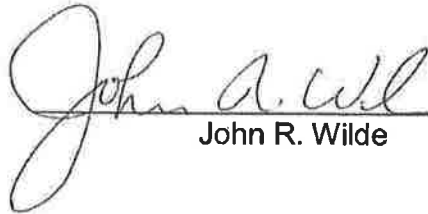
MISSOURI-AMERICAN WATER COMPANY

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-2017-0285
RATES FOR WATER AND SEWER)	CASE NO. SR-2017-0286
SERVICE)	

AFFIDAVIT OF JOHN R. WILDE

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


John R. Wilde

State of New Jersey
County of Camden
SUBSCRIBED and sworn to
Before me this 15 day of January 2018.


Notary Public

My commission expires:

SHARIFAH HILTON
NOTARY PUBLIC OF NEW JERSEY
My Commission Expires 4/25/2022

**REBUTTAL TESTIMONY
REVENUE REQUIREMENT
JOHN R. WILDE
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2017-0285
CASE NO. SR-2017-0286**

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**REBUTTAL TESTIMONY
REVENUE REQUIREMENT**

JOHN R. WILDE

1

I. INTRODUCTION

2 **Q. Please state your name and business address.**

3 A. My name is John R. Wilde and my business address is 131 Woodcrest Road, Cherry
4 Hill, New Jersey 08003.

5 **Q. Are you the same John R. Wilde who previously submitted direct testimony in this
6 proceeding?**

7 A. Yes.

8 **Q. What is the purpose of your revenue requirement rebuttal testimony in this
9 proceeding?**

10 A. Missouri Industrial Energy Consumers (“MIEC”) witness Meyer (Dir., p. 9-10) raises
11 questions about the potential effect of the Federal Income Tax changes that were then
12 being discussed before Congress. Since the filing of that testimony, Congress has
13 passed and the President has signed the Tax Cuts and Jobs Act of 2017 (“TCJA”). The
14 purpose of my revenue requirement rebuttal testimony is to: (1) explain the overall
15 impact of the TCJA on MAWC; (2) provide and explain a schedule that reflects the
16 overall effect of the TJCA on MAWC’s projected cost of service for the future test
17 year; (3) explain MAWC’s recording of deferred assets and liabilities on its books to
18 reflect the reduction in the federal corporate tax rate from 35 percent to 21 percent.

1 In addition, please see the testimony of James Jenkins for discussion of the Company's
2 application for two accounting authority orders ("AAO"s).

3 **II. OVERVIEW OF CHANGES TO MAWC'S FEDERAL TAX EXPENSE**
4 **AND ACCUMULATED DEFERRED INCOME TAXES**

5 **Q. Please generally describe the effect of the TCJA on MAWC's financial operations.**

6 A. The TCJA contains many provisions that substantially modify the Internal Revenue
7 Code, and full quantification of its impacts will take some time. The most obvious
8 impact of the TCJA is the reduction to MAWC's annual federal tax expense effective
9 beginning in 2018 resulting from the corporate tax rate cut. Another impact is on
10 MAWC's Accumulated Deferred Income Taxes ("ADIT"). For over the last thirty
11 years, MAWC's ADIT has been calculated based on the 35 percent federal tax rate.
12 With the TCJA's reduction to that rate, MAWC's ADIT balance as of the enactment
13 date of the legislation of ADIT is in a net excess position, meaning a net ADIT balance
14 overstates the taxes that will be payable in the future related to prior operations of the
15 Company. However, MAWC's ADIT balance includes both deferred tax assets
16 (DTAs), and deferred tax liabilities (DTLs) requiring remeasurement on the enactment
17 date. For MAWC, the net of those DTAs & DTLs is an ADIT liability balance and the
18 remeasurement results in a net excess deferred tax liability being identified.

19 **Q. What impact will the TCJA tax changes have on the Company's federal tax**
20 **expense and rate base?**

21 A. MAWC has calculated and projected the reduction to MAWC's annual federal tax
22 expense beginning in 2018, which must now be incorporated into the future test period
23 in this case. MAWC projects that the reduction of the corporate federal income tax rate

1 from 35% to 21% will, alone, reduce our future federal income tax expense by \$4.2
2 million. In addition, because deferred taxes after December 31, 2017 will be computed
3 using the lower rate, the prorated 13 month average ADIT has decreased. This decrease
4 in ADIT results in a rate base increase of 8.5 million. Finally, the revenue conversion
5 factor has been reduced from 1.63534 to 1.35149. These changes, result in a future test
6 year revenue requirement that is lower by \$20.3M. See Schedule JRW-1, Schedule
7 JRW-2, and Schedule JRW-3.

8 As stated above, for financial accounting purposes ADIT balances will be remeasured
9 as of the enactment date based on a federal rate of 21% , and will result in excess ADIT
10 balances being measured. These excess deferred taxes fall into two categories – those
11 subject to the normalization provisions of The Act (sometimes referred to as
12 “protected” ADIT), and those that are not (sometimes referred to as “unprotected”
13 ADIT). Pursuant to tax normalization rules and practices, the protected excess deferred
14 taxes can be returned to customers, but no more rapidly than over what is allowed under
15 one of two approved normalization methods of accounting: the Average Rate
16 Assumption Method (“ARAM”); or the Reverse South Georgia Method (“RSGM”).
17 Both ARAM and RSGM, are what was allowed by the tax normalization rules enacted
18 in the Tax Reform Act of 1986, and in general for a regulated utility to normalize or
19 amortize the excess deferred taxes into cost of service tax expense and ADIT over the
20 remaining book depreciation lives of the underlying assets. By way of contrast, the
21 unrestricted excess deferred taxes can be normalized into regulated tax expense and
22 ADIT balance over any reasonable period. MAWC has not yet completed its initial
23 remeasurement of ADIT balances and has not yet estimated the excess ADIT balances
24 that will be normalized pursuant methods discussed above.

1 **Q. Please describe the reasons why MAWC cannot fully estimate the exact amount**
2 **of the TCJA's impact on MAWC's ADIT at this time.**

3 A. The calculation of the impact that the reduction of the federal tax rate from 35% to 21%
4 on income tax expense is a relatively straightforward calculation that can be applied in
5 the context of a future test period. The calculation of the estimated impact the reduction
6 of the federal tax rate on ADIT balances that need to be normalized into future rates as
7 of the date of enactment and executing a method to normalize the resulting excess is a
8 complex and involved process. It is also a process that takes significant time, requires
9 great care, and will likely go through several subsequent refinements before being
10 considered an estimate that could be reasonably relied on. MAWC will estimate the
11 impact of the remeasurement of ADIT balances in 2017 financial statements to be
12 finalized later in February, but will revise those estimates over the next year as more
13 information becomes available and in preparing 2017 tax returns. MAWC will not be
14 required to estimate any amount for the normalization of excess ADIT balances in its
15 2017 financial statements, as normalization period would begin in 2018 as resolved
16 with the Commission and pursuant to the tax normalization rules.

17 **Q. Besides the impact on MAWC's annual tax expense and MAWC's ADIT, are**
18 **there other, less obvious, impacts of the TCJA on MAWC? If so, please explain.**

19 A. Yes, there are. While the most obvious impact of the TCJA is a reduction in the federal
20 tax rate, other ramifications of the TCJA are: Utilities will not be able to claim bonus
21 depreciation on property placed in service after September 27, 2017 unless construction
22 had begun before that date, or the property was acquired pursuant to a contract in place
23 prior to that date. If construction began prior to September 27, 2017 or the property
24 was acquired subject to a binding written contract entered into prior to that date,

1 MAWC might be eligible for 50% bonus depreciation on those property additions.
2 More clarity is needed regarding the transitional rules in the bonus provisions of the
3 Act. Provisions of the Act will likely result in the loss of deduction for some employee
4 fringe benefits incurred in the context of MAWC regulated operations, such as some
5 meals and some parking provided to employee's that was previously not taxed.

6 **Q. Does the federal income tax expense calculated by the other parties in this case**
7 **account for the reduction in federal tax expense resulting from the TCJA?**

8 A. No. The federal tax expense levels utilized by the other parties in this case are based
9 on historical levels and thus do not account for the reduction in the federal corporate
10 tax rate from 35 percent to 21 percent. The significant reduction in the federal corporate
11 tax rate was not in effect during the historical test year in this case (the 12 months ended
12 December 2016), was not in effect during the update period in this case (the six months
13 ending June 2017), was not in effect when the parties filed their testimony in this case,
14 and was not in effect during the true-up period in this case (the six months ending
15 December 2017).

16 **Q. Does MAWC believe that its customers should realize the benefits created by the**
17 **TCJA?**

18 A. Yes. As a general matter, both the current and deferred effects resulting from reduction
19 in the federal corporate tax rate from 35 percent to 21 percent will reduce MAWC's
20 federal tax expense. Given that federal tax expense is part of MAWC's current rates,
21 MAWC believes that its customers should realize the benefits of the reduced tax rate
22 on test year operations, and should realize the benefits of the reduced tax rate on prior

1 operation where applicable through established tax and regulatory normalization
2 provisions.

3 **Q. How does MAWC propose to provide the benefits of the Tax Act to its customers?**

4 A. As described in the testimony of James M Jenkins, the Company proposes that the
5 benefits be provided to MAWC's customers through a combination of lower projected
6 federal expenses in this case, increased investment by MAWC for critical
7 infrastructure, by establishing two separate regulatory mechanisms through
8 Accounting Authority Orders ("AAOs"). The first such AAO would provide for the
9 true up of the deferred taxes relating to ADIT, which are complex and difficult to
10 calculate, as I discussed above. Using an AAO would ensure that customers pay the
11 correct amount of the rate effect of this change wrought by the TCJA when it is known
12 with precision. The second AAO would return to customers the benefits of the
13 reduction in federal corporate income tax rate from January 1, 2018 to the
14 commencement of the future test year, with an offset for the increased property taxes
15 paid by the Company.

16 **Q. Does this conclude your revenue requirement rebuttal testimony?**

17 A. Yes, it does.

Missouri-American Water Company
Overall Revenue Requirement Summary
For the 12 Months Ended May 31, 2019
Schedule: CAS-1 - Pro-Forma Tax Reform Update

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Line Number	Description	Original Filing	Tax Reform Adjustment	Pro-Forma with Impact of Tax Reform *
1				
2	Total Original Cost Rate Base	\$1,345,267,265	\$8,450,189	\$1,353,717,454
3				
4	Operating Income at Present Rates	53,892,323	4,227,026	\$58,119,349
5				
6	Earned Rate of Return (Line 4 / Line 2)	4.01%		4.29%
7				
8	Requested Rate of Return	8.07%	8.07%	8.07%
9				
10	Required Operating Income (Line 2 * Line 8)	108,563,068	681,930	109,244,999
11				
12	Operating Income Deficiency (Line 10 - Line 4)	54,670,745	(3,545,096)	51,125,650
13				
14	Gross Revenue Tax Conversion Factor (Line 38)	1.63534		1.35149
15				
16	Revenue Deficiency (Line 12 * Line 14)	89,405,258	(20,309,453)	69,095,805
17				
18	Pro Forma Revenue at Present Rates	279,843,403	0	279,843,403
19				
20	Total Revenue Requirement (Line 16 + Line 18)	\$369,248,661	(\$20,309,453)	\$348,939,208

* Please see Rebuttal Testimony of John Wilde for details of adjustments included

Missouri-American Water Company
Statement of Income Per Books and Pro Forma
For the 12 Months Ended May 31, 2019
Schedule: CAS-2 - Pro-Forma Tax Reform Update

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Line Number	Description	Original Filing			Pro Forma with Impact of Tax Reform *			Change
		Present Rates Pro Forma For the 12 Months Ended 05/31/19	Pro Forma Adjustments	Proposed Rates Pro Forma For the 12 Months Ended 05/31/19	Present Rates Pro Forma For the 12 Months Ended 05/31/19	Pro Forma Adjustments	Proposed Rates Pro Forma For the 12 Months Ended 05/31/19	Proposed Rates Pro Forma For the 12 Months Ended 05/31/19
1								
2	Operating Revenues	\$279,843,403	\$89,405,258	\$369,248,661	\$279,843,403	\$69,095,805	\$348,939,208	(\$20,309,453)
3								
4	Operating Expenses							
5	Operating and Maintenance	132,958,637	670,539	\$133,629,176	132,958,637	518,219	133,476,856	(152,320)
6	Depreciation Expense	48,230,645	0	\$48,230,645	48,230,645	0	48,230,645	0
7	Amortization Expense	1,237,352	0	\$1,237,352	1,237,352	0	1,237,352	0
8								
9	Taxes other Than Income Taxes							
10	Property Taxes	25,224,554	0	\$25,224,554	25,224,554	0	25,224,554	0
11	Payroll Taxes	2,380,217	0	\$2,380,217	2,380,217	0	2,380,217	0
12	PSC Fees	3,063,651	0	\$3,063,651	3,063,651	0	3,063,651	0
13	Other	(96,291)	0	(\$96,291)	(96,291)	0	(96,291)	0
14								
15	Utility Operating Income Before Income Taxes	66,844,638	88,734,719	155,579,357	66,844,638	68,577,586	135,422,224	(20,157,133)
16								
17	Income Taxes							
18	Current Federal Income Tax	0	0	0	0	0	0	0
19	Current State Income Tax	0	0	0	0	0	0	0
20	Deferred Income Taxes	13,058,977	34,063,973	47,122,950	8,831,951	17,451,937	26,283,888	(20,839,062)
21	Amortization of Investment Tax Credit	(106,662)	0	(106,662)	(106,662)	0	(106,662)	0
22		0	0	0				
23	Utility Operating Income	\$53,892,323	\$54,670,746	\$108,563,069	\$58,119,349	\$51,125,650	\$109,244,999	\$681,930
24								
25								

* Please see Rebuttal Testimony of John Wilde for details of adjustments included

Missouri-American Water Company
 Pro-Forma Gross Up Conversion Factor
 For the 12 Months Ended May 31, 2019

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Line Number	Description	Original Company Filing	Pro-Forma with Impact of Tax-Reform 5/31/19 Test Year
1	Gross Revenue Conversion Factor		
2	Revenue	1,000.0	1,000.0
3	Uncollectibles Rate	0.7500%	0.7500%
4	Uncollectibles	7.5	7.5
5	PSC Assessment Rate	0.0000%	0.0000%
6	PSC Assessment	0.0	0.0
7	Before Tax Amount	992.500	992.500
8	SIT Rate	5.2133%	5.6307%
9	State Income Taxes	51.742	55.885
10	FIT Rate	33.1754%	19.8176%
11	Federal Income Taxes	329.266	196.689
12	Total Taxes and Expenses	388.508	260.074
13	Net Amount	611.492	739.926
14			
15	Conversion Factor	1.63534	1.35149
16			
17	Federal Tax Rate Calculation		
18	Utility Operating Income Before Taxes	1.000000	1.000000
19	State Deduction	0.052133	0.056307
20	Taxable Income	0.947867	0.943693
21	Statutory Rate	35.00%	21.00%
22			
23	Tax Rate	33.1754%	19.8176%
24			
25			
26	State Tax Rate Calculation		
27	Utility Operating Income Before Taxes	1.000000	1.000000
28	State Deduction	0.165877	0.099088
29	Taxable Income	0.834123	0.900912
30	Statutory Rate	6.25%	6.25%
31			
32	Tax Rate	5.2133%	5.6307%

* Please see Rebuttal Testimony of John Wilde for details of adjustments included