Exhibit No.:	
Issues:	Accumulated Deferred Income Taxes Including Excess Balances
Witness:	John R. Wilde
Exhibit Type:	Rebuttal
Sponsoring Party:	Missouri-American Water Company
Case No.:	WR-2020-0344
Date:	January 15, 2021

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2020-0344

REBUTTAL TESTIMONY

OF

JOHN R. WILDE

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

AFFIDAVIT

I, John R. Wilde, under penalty of perjury, and pursuant to Section 509.030, RSMo, state that I am V.P. Tax Strategy and Compliance for American Water Services Compan, that the accompanying testimony has been prepared by me or under my direction and supervision; that if inquiries were made as to the facts in said testimony, I would respond as therein set forth; and that the aforesaid testimony is true and correct to the best of my knowledge and belief.

John R Wilde

John R, Wilde

January 15, 2021

REBUTTAL TESTIMONY
JOHN R. WILDE
MISSOURI-AMERICAN WATER COMPANY
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REBUTTAL TESTIMONY

JOHN R. WILDE

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is John R. Wilde. My business address is One Water Street, Camden, NJ 08102

Q. On whose behalf are you submitting this testimony?

A. I am submitting this rebuttal testimony on behalf of Missouri-American Water Company ("Missouri-American" or the "Company").

Q. Did you previously provide direct testimony in this proceeding?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to certain portions of the Missouri Public Service Commission ("Commission") Staff Report – Cost of Service ("COS Report"), the direct testimony of Office of the Public Counsel ("OPC") Witness John S. Riley, and the direct testimony of Missouri Industrial Energy Consumers ("MIEC") witness Greg R. Meyer.

My rebuttal testimony first addresses the inclusion of accumulated deferred income taxes ("ADIT") in rate base. I address an apparent error by Mr. Riley with respect to the Company's rate base and an inadvertent error that Staff made in computing rate base that double-counts the amount of excess ADIT ("EADIT") to be included as a reduction to rate base. I then address Mr. Riley's contentions regarding the inclusion of net operating losses ("NOL") in rate base calculations. The final section of my rebuttal testimony addresses the proposals of MIEC and Staff to use an amortization period of three years and five years, respectively, for "unprotected" EADIT balances.

Q. Have you prepared any schedules to accompany your rebuttal testimony?

A. Yes, I have prepared two schedules. First, I have revised the schedule attached to my direct testimony as Schedule JRW-1 to reflect new Internal Revenue Service ("IRS") guidance regarding the treatment of certain EADIT balances and a minor correction with respect to the EADIT balance. This revised schedule is attached to my rebuttal testimony as Schedule JRW-1-R. The second schedule, attached as Schedule JRW-2-R, compares the impacts of adopting either Staff's or MIEC's proposed amortization periods for unprotected EADIT to the impact of adopting the Company's proposal to amortize plant related unprotected EADIT over a period proportional to that produced by the average rate assumption method ("ARAM"), and non-plant related unprotected EADIT over a period of 20 years.

II. ACCUMULATED DEFERRED INCOME TAXES – INCLUSION IN RATE BASE

Q. On page 2, line 18 of his direct testimony, Mr. Riley states that the Company has proposed a base line rate base balance amount in this case of $407 Million. Is this an accurate statement?

A. No. Mr. Riley does not cite a source for this amount, but assuming he is using a historic test period ending December 31, 2019, the ADIT included in rate base the Company proposed as of that date is $443 million.[1]

Q. Referring to Staff's Accounting Schedule: 2, Rate Base Schedule, Staff uses an ADIT amount as of June 30, 2020 of $451,144,884 and an EADIT amount of $148,103,888 to compute rate base as of June 30, 2020. In doing so, Staff refers to schedules provided by the Company. Are these the correct amount of ADIT and EADIT to be included in rate base as of June 30, 2020?

A. No. The correct total ADIT balance (including EADIT) to be included in rate base as of June 30, 2020 is $453,671,105[2]. This ADIT balance already includes EADIT of $148,103,888.[3] Staff apparently had inadvertently included EADIT a second time, not realizing it was already included in the total ADIT balance as proposed by the Company, thus double-counting the effect the EADIT balance as of June 30, 2020 should have on ADIT. Further it appears Staff used a number for June 30, 2020 provided by the Company that was later updated to the $453,671,105.

Q. Has Staff acknowledged the inadvertent double-counting of EADIT in its ADIT balance and that the correct total is $453,671,105?

A. Yes, that is my understanding.

Q. Mr. Riley asserts at page 2 of his direct testimony, starting on line 9, that the Company's inclusion of a net operating loss in its calculations of rate base and revenue requirement is "inappropriate." Do you agree?

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[1] Exhibit workpaper labeled "Deferred Tax Workpaper"

[2] Provided to Staff when requested additional details for the 06/30/20 tax expense calculation. The $451m was provided before that with the Company's June data update which was provided 09/11/20.

[3] DT Wilde – Schedule JRW-1.

A. No. Mr. Riley bases his argument on a false belief that the NOL is something that only exists in filing a tax return, and that it is not accounted for as a reduction of deferred tax expense, nor as part of ADIT. To the contrary, the Company accounts for the impact of its being in a net operation loss position for tax, financial, and regulatory accounting purposes. The Company does so based on established tax, financial and regulatory guidance and practice.

Q. Can you provide an example of proper accounting treatment of an NOL?

A. Yes. Assume a utility was allowed to claim bonus depreciation deductions of $100.00, but only had $50.00 of taxable income before it claimed that deduction. It would record a depreciation-related deduction of $100.00, a deferred tax liability ("DTL") of ($21.00) and an NOL related deferred tax asset ("DTA") of $10.50, for a net ADIT balance of ($10.50), which is the correct balance of tax it was able to defer as a result of having claimed bonus depreciation. It will be able to benefit from the remaining $10.50 in a future year as taxable income allows. Mr. Riley erroneously suggests that the utility should have an ADIT balance of ($21.00) reducing rate base when the Company was only able to reduce its current tax obligation to the IRS by $10.50. The offset to these deferred tax accounting entries is ADIT.

Q. On page 2 of his direct testimony, starting on line 21, Mr. Riley makes the following statement: "Under established rate making procedures, a company's rate base is reduced by the deferred tax balance ("ADIT") that has accumulated due to the difference between the regulatory depreciation balance used in ratemaking and the larger depreciation balance created by the use of accelerated depreciation methods employed for tax purposes." Is that accurate?

A. No, that is not the established practice that I am familiar with in Missouri, and it is not the established practice that I am familiar with as applied by any other state commission. The established practice of this Commission and all other commissions using a normalized method of accounting to account for deferred taxes is to include ADIT as a net balance carried on a utility's balance sheet consisting of all deferred tax assets and liabilities accumulated to date that are related to the underlying property that makes up rate base (generally Plant). Pursuant to the NARUC Uniform System of Accounts (1973/1976), those deferred tax assets and liabilities can be found in one or more of the following accounts: 186, 253, 255, 281, 282, and/or 283. Assuming those deferred tax balances have accrued and will reverse through deferred tax expense using a normalized method of accounting, as used by this Commission and most other state commissions, the deferred tax balances in each of these accounts would be included in rate base to the extent the balance relates to the utility plant and other assets and liabilities included in rate base. For example, following Mr. Riley's definition of what the ADIT balance is he would exclude all ADIT except for the ADIT that related to having claimed accelerated tax depreciation. In doing so he would not only exclude the NOL Deferred Tax Asset ("DTA") from the ADIT included in rate base, but he would also exclude the Tax Repairs Deferred Tax Liability ("DTL") from that balance. Tax repairs is not associated with having claimed accelerated tax depreciation, and is claimed pursuant to a different section of the tax code than tax depreciation. However, like the NOL DTA it is the established practice to include the entire plant related ADIT balance in rate base, including but not limited to the NOL DTA and the Tax Repairs DTL.

Q. On page 3 of his direct testimony, starting on line 2, Mr. Riley characterizes MAWC's position related to the NOLC and its impact on the Company's ADIT balance as follows: "MAWC is arguing that the NOL created by accelerated depreciation and other IRS tax advantage allowances should be applied as an offset to this ADIT rate base reduction." Is that a correct characterization?

A. No. As I previously explained, the ADIT is not a balance exclusively limited to what are generally referred to as method/life ("M/L") differences or the difference between book depreciation methods and life, and tax depreciation methods and life ("M/L Depreciation Differences"). I am not aware of any regulatory or financial accounting principle that limits and applies the definition of ADIT in the way suggested by Mr. Riley, nor has he referenced any such supporting principle. Therefore, there is no need to seek an offset to the ADIT balance already carried by the Company, or to the ADIT balances that have been historically included by the Commission as a component of rate base. It is Mr. Riley who attempts to adjust ADIT by selectively excluding items such as NOL DTAs that have a history of having been included in the ADIT balance included in rate base.

Q. In computing rate base in this case, has Staff limited the ADIT balance included in rate base to the balance related to M/L differences and excluded the portion related to the NOL, as suggested by Mr. Riley?

A. No, Staff includes the ADIT balance related to the underlying utility plant balance in its rate base calculation. The amount of ADIT on Staff Accounting Schedule 2 is a number that was provided by the Company in an update in September of 2020. This amount is $451,144,884. As discussed earlier this amount was further updated to the $453,671,105 amount. This same amount is currently included in the Company's own rebuttal June 30th rate base shown on Mr. LaGrand's schedule BWL-1. When the Company provided the number used by Staff, and when the Company puts the same number in its own rate base, it does not make any adjustment for the DTA related to the NOL. Therefore, the DTA related to the NOL balance would have been included in Staff's total in Staff Accounting Schedule 2.

Q. On pages 3 and 4 of his testimony, Mr. Riley suggests the Company's tax expense is accrued without regard to the NOL, and therefore the NOL DTA was over-collected from customers. Do you agree?

A. No. The deferral of tax resulting from the acceleration or deferral of a tax deduction has no impact on the customers' tax expense. Using the example from above, assume the $50.00 of taxable income before accounting for accelerated depreciation was the same as the utility's pre-tax income, meaning the only book to tax difference the Company had was tax depreciation. In that case, before the utility recorded tax depreciation it would have first recorded a current tax expense of $10.50 and a deferred tax expense of $0.00, for a total of $10.50 ($50.00 X 21%). In recording depreciation expense, it would have recorded a reduction of current expense of ($21.00), and an increase in deferred tax expense of $21.00. Still, the total tax expense on the utility's pre-tax income would be $10.50. However, the resulting negative current tax expense of ($10.50) implies you will get a refund from the IRS in claiming more deductions than there is taxable income to apply to those deduction. In addition, it would imply that the utility has a deferred tax expense payable to the IRS in the future of $21.00 as of that point in time. Instead, what is allowed and what is the reality is the IRS allows the utility to take its taxable income and tax to zero, and to carry any loss over to a future year as a NOL deduction. To record the NOL the utility would record an increase of $10.50 to current tax expense resolving current tax expense to zero, which is what the utility will pay, and record a decrease in deferred tax expense of ($10.50) with the deferred tax expense now totaling $10.50. Total tax expense recorded and collected from customers would be $10.50, and would be related to having earned a $50.00 return on rate base. The $10.50 in tax expense remains the same regardless of the deferred tax accounting. Customers would benefit with a reduction in rate base for ADIT of ($10.50), equaling the utility's net outstanding amount owed to the IRS in future periods. Mr. Riley incorrectly suggests that the amount of the ADIT balance impacting rate base should be ($21.00), even though that would be greater than the tax expense paid by the customers, and greater than the amount by which the Company was able to reduce its tax obligations.

Q. On page 3 of his testimony, starting on line 5, Mr. Riley suggests that the NOL need not be included because a portion of that NOL has been identified as unprotected and not subject to the tax normalization rules. Would his suggestion to exclude the entire NOL due to the fact that part of the NOL is unprotected result in a normalization violation?

A. Yes, as has the IRS consistently ruled. In addition, the consequences of that violation would not be tempered by the fact that only part of the NOL was subject to those rules.

Q. If he were suggesting that only the unprotected NOL ADIT be excluded, would that adjustment to ADIT be appropriate in the context of a base rate case?

A. No. While it would not be a violation of the tax normalization rules, it would be contrary to established practice in base rate cases where the full NOL has consistently been included, and would be inconsistent with the facts relevant to a base rate case where there is no issue in measuring the amount of NOL present using a historic test period.

III. AMORTIZATION METHOD AND PERIOD FOR EADIT BALANCES

Q. Please describe Schedule JRW-1-R.

A. As noted above, Schedule JRW-1-R is a revised version of the schedule attached to my direct testimony as Schedule JRW-1. The revisions reflect new Internal Revenue Service ("IRS") guidance regarding the treatment of certain EADIT balances and a minor correction with respect to the EADIT balance. Specifically, the IRS guidance allowed the Company to change the labeling of items that were uncertain, to protected or unprotected as appropriate. As a result of this guidance, the negative EADIT related to the Net Operating Carryforward was split into its protected and unprotected portions based on a with and without test, and Cost of Removal was changed to unprotected. In addition, Missouri Corporate income tax law allows for a deduction of federal tax when computing Missouri state income tax. This results in effectively having a lower state income tax rate than the statutory rate. While the EADIT in the prior exhibit and data response did contain the EADIT for this effect for items tracked in the PowerTax system related to plant items, it did not include the amount of EADIT related to any non-plant or plant-related EADIT maintained outside of the PowerTax system. These amounts have now been included. This revised schedule is attached to my rebuttal testimony as Schedule JRW-1-R.

A. "Protected" EADIT Amortization

Q. Do the witnesses for Staff and MIEC agree with the Company's proposed amortization method and life for "protected" EADIT?

A. Yes. MAWC has proposed that protected EADIT balances be amortized using ARAM, as required by the Tax Cuts and Jobs Act (18 §13001(d)(1)) ("TCJA"). Staff witness Bolin agrees with this method and life for protected balances. (COS Report, p. 77). MIEC witness Meyer also agrees with this method and life for protected balances. (Meyer DT, p. 30).

B. "Catchup Period" EADIT Amortization

Q. Does Staff agree with the Company's proposed amortization period for EADIT that amortization that would have occurred during the "catchup period" (the period between the date of enactment of the TCJA and the effective date of new rates)?

A. Yes. MAWC has proposed that the amortization of all EADIT balances that would have occurred from January 1, 2018 through effective date of new rates authorized in this case ("Catchup Period)" be amortized using a 5-year amortization period. Staff witness Bolin agrees with this method and life for catchup protected balances. (COS Report, p. 79).

Q. Does MIEC witness Meyer agree with the Company's proposed amortization for the Catchup Period EADIT balance?

A. No. Mr. Meyer proposes a period of three years to amortize the protected EADIT that would have been amortized during the Catchup Period. (Meyer DT, p. 30).

Q. Is Mr. Meyer's proposal consistent with the Stipulation and Agreement entered into by MIEC in MAWC's last rate case?

A. No, it is not. In MAWC's last rate case (Case No. WR-2017-0285), MIEC entered into an unopposed Stipulation and Agreement with the Company, Staff, OPC and other parties to resolve a number of issues, including the treatment of EADIT that would have been credited to customers during the Catchup Period. In so doing, MIEC, together with Staff, OPC, the Company and others, expressly stipulated and agreed to amortization of the

Catchup Period balance over ***five years***:

> To the extent it does not create a normalization violation, until the normalization begins to be provided to customers, a tracker will capture the normalization that would have occurred in prior periods and will be held until the next rate case. ***At the time of the next rate case, the tracker balance will be amortized over five years.*** Tracking of excess ADIT will begin as of January 1, 2018.[4]

Since MIEC stipulated and agreed that a five-year amortization of the EADIT that would have been credited to customers during the Catchup Period would be implemented in this rate case, Mr. Meyer's attempt to advocate a different amortization period on behalf of MIEC in this proceeding should be rejected.

C. "Unprotected" Plant and Non-Plant EADIT Amortization

Q. Do the witnesses for Staff and MIEC agree with the Company's proposed amortization method and life for "unprotected" plant and non-plant EADIT balances?

A. No. MAWC has proposed that unprotected plant-related EADIT be amortized using ARAM, consistent with the method and life used for protected plant-related EADIT balances, and consistent with the period over which the deductions related to investment in utility plant that gave rise to the EADIT will be recovered from customers. MAWC has proposed that unprotected ***non***-plant EADIT be amortized using a 20-year period, consistent with the reversal period of the underlying book to tax differences. Staff witness Bolin proposes that a 5-year amortization period be used for all "unprotected" EADIT balances. (COS Report, p 78). MIEC witness Mr. Meyer proposes a 3-year period for

[4] *In the Matter of Missouri-American Water Company's Request for Authority to Implement a General Rate Case increase for Water and Sewer Service Provided in Missourch Service Areas*, Case No WR-2017-0285, Stipulation and Agreement at 4 (filed Mar. 1, 2018) (emphasis added).

unprotected EADIT balances. (Meyer DT, p. 28).

Q. Given the positions of the other witnesses regarding the relevant amortization method and life to use for unprotected EADIT balances, has the Company changed its proposed amortization period for unprotected EADIT balances?

A. No, the Company continues to believe its proposal best serves the long-term interest of MAWC customers.

Q. Have you prepared a schedule comparing the impacts of the various proposals for amortizing the Company's unprotected EADIT balances?

A. Yes. Schedule JRW-2-R, attached to this testimony, compares the net revenue requirement impact of adopting either Staff's proposed 5-year amortization period or MIEC's proposed 3-year amortization period for unprotected EADIT (page 1) to the impact of adopting the Company's proposal to amortize plant related unprotected EADIT over a period proportional to that produced by the average rate assumption method ("ARAM"), and non-plant related unprotected EADIT over a period of 20 years. To illustrate the impact that a shorter amortization period than that produced by ARAM would have on the customer rates over the life of the underlying property, Schedule JRW-2-R also shows the effect of using 10-year (Page 2) and 20-year (Page 3) amortization periods for the Company's unprotected EADIT.

Q. How do you respond to the proposals of MIEC and Staff to amortize unprotected EADIT over three years and five years, respectively?

A. Mr. Meyer and Ms. Bolin completely ignore several adverse effects that such accelerated amortization will have on customers and rates after the unprotected EADIT is exhausted.

Use of a shorter amortization period would create inter-generational inequity by severing the amortization of unprotected EADIT balances from the related investment and the funding of that investment by customers. Proposals to use a shorter life, if adopted, would distribute a tax benefit to customers in a manner that is disproportionate to the cost and risk that customer bears in taking service, and thus benefits customers during the abbreviated amortization period to the detriment of customers who continue to pay for these investments over the property's remaining useful life. Moreover, as shown on Schedule JRW-2-R and discussed below, proposals to amortize EADIT over an abbreviated time frame such as 3 years or 5 years would result in a substantial rate increase after the unprotected plant-related EADIT is fully normalized. In contrast, and as illustrated, the use of ARAM will add to the stability of cost of service rates over the useful life of the property.

Q. How does the use of ARAM for this purpose address these issues?

A. First, as I explained in my direct testimony, using ARAM to normalize all EADIT related to plant in service (both protected and unprotected) justly promotes inter-generational equity. All of the plant-related EADIT are unrealized permanent tax benefits that accrued as a result of the Company making investments in plant in service and claiming tax deductions in excess of book at a time when the federal corporate income tax rate was 35%, that will be realized as they reverse at a rate that is currently assumed to be 21%. However, as a result of the TCJA, we expect the tax benefits to reverse as book depreciation is recovered as a cost from customers when the tax rate will be 21%. These unrealized permanent benefits, which relate to the deduction of costs not yet recovered in rates from customers, should be returned equitably to those same customers who will be required to pay the costs of the plant to which the tax benefits relate as those tax benefits are realized.

The use of ARAM as proposed by the Company closely aligns the normalization of these tax benefits to the investments that gave rise to the tax benefits, and thus to the customers who will bear the costs of those investments over the investments' lives. Second, as I also explained in my direct testimony, the use of ARAM reduces the total cost of capital recovered from customers over the underlying useful life of the plant in service investment.

Q. Please explain further how using ARAM to normalize EADIT promotes inter-generational equity.

A. A normalization method of accounting such as ARAM prevents the inter-generational inequity that can occur when an alternative method flows-through the tax benefit to customers over a shorter period of time than is used to recover the investment that gave rise to the tax benefit. If MAWC uses an immediate or close-to-immediate flow-through method of accounting for unprotected EADIT amortization, current customers receive the entire tax benefit disproportionally. As I explained in my direct testimony, this occurs even if tax rates change again before the timing difference reverses. For example, assume an EADIT balance has been generated with respect to the tax benefits associated with an asset with a book depreciation life of 35 years. If a shorter flow-through method is used for the EADIT, customers who take service during the flow-through period realize 100% of the benefit from the TCJA, whereas the customers paying for the asset during the remainder of its life realize none of the benefit. The asset giving rise to the benefit, however, will serve all of them. What is also inequitable for those later customers is the accelerated increase in rate base. The entirety of the EADIT will have already been returned over the flow-through period, resulting in a larger rate base and thus a greater revenue requirement for the remainder of the life of the asset giving rise to the benefit. Future customers are unfairly penalized, and doubly so, because they may not receive any refund, and yet pay for the cost of the utility asset over its remaining useful life. Even worse, if tax rates are raised in the future, future generations will have to pay for the deficient ADIT because any prior excess will have been refunded to prior customers. Normalization ensures that tax benefits are spread to all customers who benefit from the Company's long-lived assets and not just current customers. MAWC therefore believes that the normalization concept should be applied to all plant-related EADIT and its amortization should be calculated pursuant to ARAM without regard to its status as protected or unprotected.

Q. Have you estimated the impact on customers and rates if Staff's 5 year or MIEC's 3-year amortization period were to be adopted?

A. Yes. As demonstrated on Schedule JRW-2-R (page 2), if the five year amortization period were adopted, MAWC customers would end up paying over $115.2 million more over the life of the assets that gave rise to the unprotected plant-related EADIT than they would if the EADIT were normalized pursuant to ARAM. Schedule JRW-2-R (Page 2) also demonstrates the significant increase in customer revenue requirement that occurs in year 6 when the unprotected EADIT amortization ends. Schedule JRW-2-R further shows for comparison purposes the impact on revenue requirement if unprotected EADIT were amortized over 3-year (page 1), 10-year (page 3), and 20-year (page 4) periods.

Q. Do you see any issues with Mr. Meyer's proposal (page 31, starting on line 3) that some form of accounting mechanism be in place to true-up for the impact on rate base related to the amortization of EADIT in periods subsequent to the historic test year?

A. No, the Company does not disagree with the use of an accounting mechanism to address a true up of rate base, but it should cover all of the following and not just be limited to a rate base adjustment related to protected EADIT: (1) over or under amortizations of both protected and unprotected EADIT; (2) change in revenue requirement driven by the change in rate base due to the amortization of both protected and unprotected plant related EADT; and (3) change in both protected and unprotected EADIT balances resulting from a change in tax law or audit by the IRS.

Q. Does this conclude your Rebuttal Testimony?

A. Yes, it does.