

Exhibit No:
Issue: Income Tax
Witness: L. Jay Williams
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Empire District Electric
Docket No: ER-2010-0130
Date Testimony Prepared: April 2010

**Before the Public Service Commission
of the State of Missouri**

Rebuttal Testimony

Of

L. Jay Williams

April 2010

REBUTTAL TESTIMONY
OF
L. JAY WILLIAMS
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2010-0093

1 **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. L. Jay Williams. My business address is 602 Joplin Street, Joplin, MO.

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

5 A. I am employed by The Empire District Electric Company (“Empire” or
6 “Company”) as Manager of Tax Planning.

7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND WORK**
8 **BACKGROUND.**

9 A. I graduated from Missouri Southern State University with a BS in Business
10 Administration (emphasis in accounting) in 1975. I hold certificate number 8047
11 from the Missouri State Board of Accountancy. Prior to joining Empire in 1983, I
12 spent 6 years in public accounting, primarily in the income tax field. Except for a
13 short period in Empire’s Internal Auditing Department, I have spent my entire
14 tenure in the tax area of the Company. My tax experience at the Company
15 includes the responsibility for tax compliance in the areas of property, sales/use,
16 corporate franchise and income taxes.

17 **Q. HAVE YOU FILED TESTIMONY PREVIOUSLY BEFORE THE**
18 **MISSOURI PUBLIC SERVICE COMMISSION (“COMMISSION”)?**

1 A. Yes.

2 **EXECUTIVE SUMMARY**

3 **Q. PLEASE BRIEFLY SUMMARIZE YOUR REBUTTAL TESTIMONY.**

4 A. My rebuttal testimony concerns the proposed recovery of state deferred income
5 taxes that were flowed through for the benefit of ratepayers by Empire from 1954
6 through 8/15/1994, but were never recovered from ratepayers through rates, and
7 was omitted by the Staff in their tax calculation in this case.

8 **RECOVERY OF DEFERRED STATE INCOME TAXES**

9 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY CONCERNING**
10 **DEFERRED STATE INCOME TAXES?**

11 A. From 1/1/1954 to 8/15/1994, Empire flowed through the state income tax benefits
12 of accelerated depreciation to ratepayers. Deferred income tax expense included
13 in the Company's cost of service included only the deferred federal income tax
14 computed at the statutory rates in effect during that period. As a result, ratepayers
15 gained the benefit of the state deferred income tax expense.

16 **Q. WHAT EVIDENCE EXISTS THAT EMPIRE FLOWED THROUGH THE**
17 **DEFERRED STATE INCOME TAX BENEFITS TO RATEPAYERS?**

18 A. From 1/1/1954 through 8/15/1994, it was the Company's practice to flow through
19 to ratepayers, income tax benefits that were not required to be normalized. A
20 1956 Accounting Order required the Company to record for financial reporting
21 purposes federal deferred income taxes for the timing differences related to the
22 use of accelerated depreciation. That order was explicit that only federal deferred
23 taxes be recorded. Another Accounting Order issued in the 1970's specified the

1 recording of federal deferred income tax expense related to the tax amortization of
2 pollution control facilities for financial reporting purposes. However, the
3 Company was not authorized by the Commission to use normalization in
4 ratemaking until 1970 when the Company requested and received the
5 authorization letter (letter dated 12/17/70). Had the Company normalized federal
6 or state deferred taxes in rates prior to 1970 it would not have needed this
7 authorization letter. Also, IRS regulations stemming from provisions in the 1969
8 Tax Reform Act included certain normalization requirements of federal deferred
9 income taxes for ratemaking and financial reporting purposes. State income tax
10 benefits were not protected under this Act and, therefore, could be flowed through
11 to customers without violation of the normalization rules. In compliance with
12 Commission orders specifying the recording of deferred federal income taxes and
13 the IRS requirement that only federal income taxes be normalized, state deferred
14 income taxes were not included in Empire's rates.

15 **Q. DID ANY OF THE RATE PROCEEDINGS FROM THE PERIOD 1/1/1954**
16 **TO 8/15/1994 OR GENERAL ORDERS RESULT IN ANY**
17 **PRONOUNCEMENT FROM THE COMMISSION REQUIRING THE**
18 **NORMALIZATION OF STATE DEFERRED INCOME TAXES?**

19 A. No. My research reveals there were no Commission decisions from 1954 through
20 1973 directing the use of tax normalization ratemaking treatment for accumulated
21 State deferred income taxes from accelerated depreciation.

22 **Q. IS THIS SIGNIFICANT?**

23 A. Yes.

1 **Q. WHY?**

2 A. Had the Commission authorized tax normalization in rates, that would have
3 required the accumulated State deferred income taxes to be used to reduce rate
4 base in cases prior to 1970.

5 **Q. DO YOU KNOW IN WHAT RATE CASE THE COMMISSION BEGAN**
6 **ALLOWING THE RECOVERY OF STATE INCOME TAXES?**

7 A. No. With respect to this issue, all the rate cases that the Company was involved
8 in from 1973 to 1994 were negotiated settlements. With the exception of the
9 1994 case, the Company negotiated these settlements using only the statutory
10 federal income tax rate to determine deferred income tax expense.

11 **Q. WHAT IS THE SIGNIFICANCE OF THE PERIOD 1/1/1954 TO 8/15/1994?**

12 A. The Internal Revenue Code first allowed the use of accelerated depreciation
13 beginning 1/1/1954 which created a timing difference between tax and book
14 depreciation. With the rates that went into effect on 8/15/1994, Empire began
15 receiving state deferred income tax in its income tax expense component of cost
16 of service.

17 **Q. WHY DID EMPIRE NOT RECEIVE THE STATE INCOME TAX**
18 **BENEFITS IN RATES PRIOR TO 8/15/1994?**

19 A. Empire had, until 8/15/1994, consistently flowed through the federal income tax
20 benefits of certain non-property related timing differences to ratepayers. The
21 Company recognized in 1994 that continuing to flow through state deferred
22 income tax benefits was beneficial to current ratepayers at the expense of future
23 ratepayers. The Company therefore changed policy and decided to seek

1 settlement of that particular case and future proceedings with the state deferred
2 income tax normalized (not flowed through).

3 **Q. IF THE FLOW-THROUGH OF STATE DEFERRED INCOME TAX**
4 **BENEFITS ENDED IN 1994 WHY IS THE COMPANY NOW SEEKING**
5 **THE RECOVERY OF THOSE AMOUNTS?**

6 A. In 1994, the Company did not realize that normal ratemaking procedures would
7 not allow for the flowed through benefits to be recovered. In the ratemaking
8 process, reversals of timing differences originally deferred at only the federal
9 statutory rate reverse at the composite federal and state rates. This mechanically
10 returns state deferred income tax expense to ratepayers that were not provided to
11 the Company previously in rates.

12 **Q. WHAT CAUSED THE COMPANY TO DISCOVER THIS PROBLEM?**

13 A. As part of the Company's compliance with Sarbanes-Oxley ("SOX"), the
14 Company analyzed the components of the regulatory assets booked under FAS
15 109 representing revenues associated with accumulated flowed through deferred
16 income taxes to be recovered from future ratepayers. The Company identified
17 and analyzed the amounts and the recoverability of the deferred state income
18 taxes previously flowed through to ratepayers. Due to the fact that the deferred
19 income taxes provided previously in rates at only the federal statutory rate would
20 be amortized (turned around) at the composite federal and state statutory rates in
21 the normal ratemaking computation, an amount needed to be added to deferred
22 income tax expense to keep from returning to ratepayers the state deferred income
23 taxes which the Company had never been provided.

1 **Q. HOW DOES THE COMPANY PROPOSE TO RECOVER THE STATE**
2 **DEFERRED INCOME TAXES AND WHAT IS THE AMOUNT?**

3 A. The Company proposes to recover the deferred state income taxes under the
4 "South Georgia" method whereby \$2,347,760 (for which the Company has
5 recorded, for financial reporting purposes, a deferred state income tax liability and
6 a corresponding regulatory asset) will be recovered ratably over the estimated
7 remaining life of the assets involved which would be 18 years, at \$130,431 per
8 year.

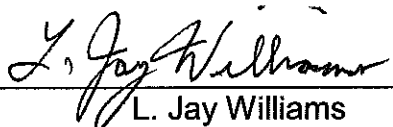
9 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

10 A. Yes, it does.

AFFIDAVIT OF L. JAY WILLIAMS


STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 31 day of March, 2010, before me appeared L. Jay Williams, to me personally known, who, being by me first duly sworn, states that he is the Manager of Tax Planning of The Empire District Electric Company and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.



L. Jay Williams

Subscribed and sworn to before me this 31 day of March, 2010.



Notary Public

My commission expires
10-30-10

VICKI L. KRAMER-GIBSON
Notary Public - Notary Seal
STATE OF MISSOURI
Jasper County - Comm#06482169
My Commission Expires Oct. 30, 2010