

documentation for previously estimated ISRS investment a minimum of two weeks prior to Staff's recommendation filing date.

MAWC filed its *Response to Staff's Recommendation* on April 26, 2019, specifically objecting to Staff's treatment of net operating losses ("NOLs"). MAWC's *Response* accepted and indicated agreement with *all other* adjustments identified in the Staff Recommendation. On April 29, 2019, the Commission issued its *Order Setting Prehearing Conference* setting a prehearing conference for May 2, 2019. On May 1, 2019, the parties filed their *Joint Proposed Procedural Schedule and Request to Cancel Prehearing Conference*. However, later that same day the Commission issued its *Order Rejecting Proposed Procedural Schedule and Denying Request to Cancel Prehearing Conference*, indicating, "[a]s the parties' joint proposed schedule conflicts with the needs of the Commission in deciding the case, the Commission will reject it." The prehearing conference took place as originally scheduled, and later on May 2, 2019, the parties filed their *Second Joint Proposed Procedural Schedule*. An evidentiary hearing took place on May 17, 2019, during which the parties presented a total of six witnesses and entered thirteen exhibits into the record as evidence.

Introduction

Staff filed the parties' joint *List of Issues, List and Order of Witnesses, Order of Cross-Examination and Order of Opening* on May 14, 2019, which presented a single issue to be decided by the Commission, set forth in the Argument section below.

Argument

Issue: In determining MAWC's ISRS rates in this case, under the applicable statute, may MAWC's accumulated deferred income tax (ADIT) balance in rate base be reduced by the ADIT asset resulting from its net operating loss(es), if any?

No. The Commission ruled on this very issue in Case No. WO-2018-0373, finding that:

MAWC has not provided evidence to support that it will in fact have an NOL in 2018. On the contrary, the evidence indicates MAWC is generating more revenue for 2018 than it is generating expenses that qualify for deductions. Thus, MAWC is expected to utilize prior NOL carryovers to offset its taxable income in 2018 and 2019, but will not generate a new NOL. Since the IRS Private Letter Rulings only address periods where an NOL is generated, there is no legal support for MAWC's position that an exclusion of an NOL would violate normalization requirements of the IRS Code.

Because MAWC is expected to have taxable income in 2018, it is reasonable to conclude that MAWC is not generating an NOL during the 2018 ISRS Period at issue, either. And in fact, there was no evidence of an NOL being generated during the 2018 ISRS Period. In short, although the ISRS statute requires recognition of ADIT, which might include reflection of an NOL, we cannot allow MAWC to reduce its ADIT balance to reflect an NOL that does not exist.¹

The Commission should reach the same conclusions in this case, and approve Staff's recommended ISRS revenues and associated rates based on the argument outlined below:

Since the conclusion of Case No. WO-2018-0373, MAWC's NOL carryforward ("NOLC") balance has been consistently decreasing on an overall basis, and is expected

¹ Report and Order, *In the Matter of the Petition of Missouri-American Water Company for Approval to Establish an Infrastructure Replacement Surcharge (ISRS)*, WO-2018-0373, issued December 5, 2018, pg. 8.

to continue to do so over the course of 2019.² This indicates that MAWC is currently not generating a net operating loss, in the aggregate, and that the ISRS investment in this period has not prevented MAWC from utilizing its past NOLC balances. While Staff generally agrees with the concept of offsetting ADIT deferred tax liabilities with deferred tax assets related to incurred NOLs in order to recognize a utility's currently inability to utilize all of the tax deductions available to it for which deferred taxes were booked,³ that approach is not appropriate in this instance. MAWC is projecting that it will be able to reflect all of its net accelerated depreciation benefits associated with ISRS plant additions on its books during 2018, 2019, and beyond, without the need to record any new offsetting NOL amount.⁴ Thus, MAWC expects to be fully able to utilize any and all tax deductions arising from the ISRS period at issue. Despite this, MAWC contends that the Commission must impute a hypothetical amount of NOLs into rate base in this case to recognize NOLC amounts that were booked in a prior period; Staff disagrees.

As such, Staff recommends the Commission approve Staff's recommended ISRS surcharge revenues in the incremental pre-tax revenue amount of \$8,878,845,⁵ and approve the following rates for each class:

Rate A	\$0.47220
Rate B	\$0.00851
Rate J	\$0.00813 ⁶

² Ex. 6, Direct Testimony of Karen Lyons, at p. 5 In. 17 – p. 6, In. 1.

³ Ex. 8, Direct Testimony of Mark L. Oligschlaeger, p. 6, Ins. 4-15.

⁴ *Id.*, at pg. 7, Ins. 5-13; Ex. 6, p. 5, Ins. 8-21; Ex. 9, Rebuttal Testimony of Mark L. Oligschlaeger, at pg. 4, Ins. 13-16.

⁵ Ex. 6, p. 2, Ins. 4-5.

⁶ Ex. 10, Direct Testimony of Matthew J. Barnes, p. 2, In. 10.

MAWC filed its *Petition* on February 20, 2019, based on actual ISRS-eligible plant expenditures from October 1, 2018, through January 31, 2019, with estimated ISRS costs through March 31, 2019; MAWC updated February and March investments to include actual numbers while Staff was conducting its audit. After Staff issued its Recommendation, MAWC recognized Staff's recommended exclusions, resulting in a revenue requirement recommended by the Company of \$9,706,228.⁷ This amount is \$827,383 higher than Staff's recommended revenue requirement of \$8,878,845, and results from differing calculations of the amount of deferred income taxes used to offset ISRS rate base.⁸

A. Accumulated Deferred Income Taxes

As described by Staff Witness Karen Lyons, accumulated deferred income taxes ("ADIT"), in effect, represent a net prepayment of income taxes by a utility's ratepayers prior to the actual payment of income taxes by a utility to a taxing authority.⁹ A utility is able to use "accelerated depreciation" deductions for tax purposes under the Internal Revenue Service ("IRS") Code. In contrast, for ratemaking purposes, the depreciation expenses utilized to calculate rates are much lower than the depreciation deductions utilized for tax purposes; for ratemaking purposes depreciation expense is calculated on a "straight-line" basis.¹⁰ This results in what is referred to as a "book-tax timing difference," and creates a deferral of income taxes to the future;¹¹ utilities collect more income tax expense within their rates than they actually pay to the government in a given

⁷ Ex. 4, Direct Testimony of Brian W. LaGrand, p. 4, ln. 23.

⁸ *Id.* at p. 5, lns. 1-4; Ex. 6, p. 2, lns. 4-15.

⁹ Ex. 6, p. 3, lns. 16-18..

¹⁰ Ex. 8, p. 3, lns. 7-10.

¹¹ Ex. 6, p. 3, lns. 20-21.

year. As Staff Witness Mark L. Oligschlaeger explained in his direct testimony, the portion of the expense collected from customers that is actually paid to taxing authorities in the short-term is charged to *current* income tax expense accounts, while the portion of the income tax expense collected from customers that will be retained by the utility until later periods is charged to *deferred* income tax expense accounts.¹² The difference in income taxes paid by the utility and those amounts collected by the utility in rates, are accumulated to recognize future tax obligations, and are considered a source of interest-free funds for a utility. Both Ms. Lyons and Mr. Oligschlaeger explain in their direct testimonies, that in order to recognize this contribution of interest-free funds from ratepayers, the utility's rate base is offset by that amount of deferred taxes, which in turn reduces the rates ultimately charged to ratepayers.¹³

In the context of a general rate case, in instances where a utility incurs a net operating loss, the utility's ADIT balance would be offset by the amount of the NOL.¹⁴ A NOL results when costs deducted for tax purposes during the relevant period exceed income recognized for tax purposes during the same period;¹⁵ in other words, a NOL would result when a utility does not have enough taxable income to utilize all of the tax deductions to which it would otherwise be entitled. When this occurs, the amount of the unused deductions is referred to as an NOL and is booked to a deferred tax asset account.¹⁶ As explained by MAWC Witness John R. Wilde, and Staff Witness Karen Lyons, ADIT includes both deferred tax assets, and deferred tax liabilities.¹⁷

¹² Ex. 8, p. 4, Ins. 16-22.

¹³ Ex. 6, p. 3, Ins. 21-24; Ex. 8, p. 5, Ins. 2-4.

¹⁴ Ex. 6, p.4, Ins. 2-3.

¹⁵ Ex. 1, Direct Testimony of John R. Wilde, p. 16, Ins. 5-7.

¹⁶ Ex. 8, p. 5, Ins. 13-17.

¹⁷ Ex. 1, p. 4, Ins. 16-18; Ex. 7, Rebuttal Testimony of Karen Lyons, 2, 1-4.

Utilities have argued that the rate base reduction for ADIT must be offset by a deferred tax asset related to NOLs, in order to reflect the fact that they were not able to currently use all of the tax deductions available to them, and for which deferred taxes were booked.¹⁸ The Commission has followed this approach in the past,¹⁹ and Staff generally agrees with this position; however, as explained by Mr. Oligschlaeger, any affected utility in this position would need to demonstrate that the NOL deferred tax asset resulted from regulated activity, and that the utility was not able to receive any actual cash flow benefit from the depreciation deductions giving rise to the NOLs, before NOL deferred tax assets are included in utility rate base.²⁰

B. ADIT and ISRS

Section 393.1000(1)(a), RSMo,²¹ defines “Appropriate Pretax Revenues” as:

[T]he revenues necessary to produce net operating income equal to: (a) The water corporation’s weighted cost of capital multiplied by the net original cost of eligible infrastructure system replacements, including recognition of accumulated deferred income taxes and depreciation *associated* with eligible infrastructure system replacements which are included in a currently effective ISRS. (emphasis added).

Only those costs directly associated with qualifying ISRS plant that became in-service during the ISRS period should be reflected in ISRS rates resulting from this proceeding. In determining the appropriate amount of associated ADIT to reflect in ISRS rates, both Staff and MAWC calculated the ISRS-related deferred tax liability of the Company in the same manner; however, MAWC took the additional step of offsetting that deferred tax

¹⁸ Ex. 6, Ins. 6-8.

¹⁹ In the Matter of Union Elec. Co., d/b/a Ameren Missouri Tariff to Increase Its Revenues for Elec. Serv., 320 P.U.R.4th 330 (Apr. 29, 2015).

²⁰ Ex. 8, p. 6, Ins. 12-15.

²¹ Commission Rule 4 CSR 240-3.650(1) outlines the identical requirements.

liability with an imputed deferred tax asset relating to an assumed NOL amount,²² in order to reflect a delay in the use of the Company's NOLC currently on its books to a future period. MAWC asserts, as explained by MAWC witness John R. Wilde, that not including this "imputed" NOL would be inconsistent with a normalized method of accounting required in the Company's consent agreement with the IRS, and thus, could result in the loss of significant tax benefits that currently benefit customers.

However, as Mr. Oligschlaeger explained in his rebuttal testimony, MAWC's proposed inclusion of a hypothetical NOL deferred tax asset in ISRS rate base in this case is not reasonable on its own terms in the circumstances of this case, and is not in any way mandated by the IRS Code tax normalization requirements.²³

C. MAWC Is Not Generating a Net Operating Loss

In the case at hand, as it did in Case No. WO-2018-0373, MAWC has again taken the position that a NOL amount should be offset against the ADIT balance in rate base for purposes of determining ISRS rates. MAWC Witness Wilde asserts that it is the Company's position that the incremental ISRS-eligible investments would generate tax deductions in excess of income generated, so on an incremental basis, there would be a tax loss generated.²⁴ However, a closer look at MAWC's argument reveals that this "taxable loss" is not, in fact, a NOL generated during the ISRS period at issue; instead, it is an estimate of the reduction to the amount of NOL carry-forward MAWC will utilize in the 2018 and 2019 tax years due to ISRS investments. Mr. Wilde says as much in his rebuttal testimony, stating that, with respect to ISRS eligible property, MAWC will be able

²² Ex. 6, p. 2, Ins. 11-13.

²³ Ex. 9, Rebuttal Testimony of Mark L. Oligschlaeger, p. 1, Ins. 17-20.

²⁴ Ex. 1, p. 15, Ins. 15-17.

to claim approximately \$34 million of incremental tax depreciation and tax repair deductions on its tax returns for 2018 and 2019, and as such, there will be an actual change of (\$34) million in the NOL deduction being claimed on the company's respective 2018 and 2019 tax returns.²⁵ MAWC argues that the ISRS process has and will result in a delay in the rate at which it can use prior accumulated NOL amounts as a carry-forward against future taxable income. Mr. Wilde testifies that, as of December 31, 2018, the Company would have been able to utilize more NOLs from prior periods had it not made any ISRS investments, and would have had a projected NOLC amount of \$98.3 million, as compared to \$105.3 million including the ISRS investment.²⁶ However, as explained by Staff Witness Oligschlaeger in his rebuttal testimony, a shortfall between the actual amounts of NOL available to offset taxable income in a given period compared to the level of NOL available for that purpose under a different and hypothetical scenario cannot reasonably be considered to constitute an "increase" in NOL, especially when the overall balance of the utility's NOL is decreasing.²⁷

As was the case in MAWC's last ISRS case, MAWC is not generating new amounts of NOLs. Since the conclusion of Case No. WO-2018-0373, MAWC's NOLC balance has been consistently decreasing on an overall basis, and is expected to continue to do so over the course of 2019.²⁸ Even when considering the ISRS investment that is the subject of this proceeding, MAWC expects to use prior booked amounts of NOL as carryforwards to offset taxable income in 2018, 2019, and beyond. This indicates that MAWC is projecting that it will be able to reflect all of its net accelerated depreciation benefits on its

²⁵ Ex. 2, Rebuttal Testimony of John R. Wilde, p. 3, Ins. 4-8.

²⁶ Ex. 1, p. 20, Ins. 1-11.

²⁷ Ex. 9. P. 6, Ins. 18-22.

²⁸ Ex. 6. P. 17-19

books associated with ISRS plant additions from January 1, 2018, forward, without the need to record any new offsetting NOL amount.²⁹

While MAWC is not generating new NOL amounts, it does still have a NOL deferred tax asset on its books that was generated for a period of time through the end of 2017;³⁰ Staff asserts that this NOL deferred tax asset was reflected in rate base, as an offset to ADIT, in MAWC's most recent general rate case; Case No. WR-2017-0285.³¹ As explained by Staff Witness Oligschlaeger at hearing, the normal accounting and ratemaking conventions hold that a utility collects, from customers, rates designed to recover its expenses, and hopefully to earn a reasonable profit, on a going forward basis.³² Further, when setting rates, an "honest and intelligent forecast of probable future values, made upon a view of all the relevant circumstances, is essential."³³ While all revenue requirement issues were resolved in Case No. WO-2017-0285 by a *Stipulation and Agreement*³⁴ filed on March 1, 2018, it must be assumed that all relevant factors were considered in setting MAWC's rates. Income tax expense is one such factor that would be considered when setting those rates; as is the reduction to a utility's rate base made to reflect a utility's balance of ADIT. It follows that

²⁹ Ex. 8, pg. 7, Ins. 8-11; Ex. 2, p. 5, Ins. 7-11.

³⁰ Ex. 6, p. 5, Ins. 8-10; Ex. 9, p.2, Ins. 1-2.

³¹ Ex. 6, p. 5, Ins. 10-12; Ex. 9, p. 2, Ins. 2-3.

³² Tr. Vol. 2, p. 81, Ins. 11-22.

³³ ***State ex rel. Missouri Water Co. v. Public Service Commission***, 308 S.W.2d 704, 719 (Mo. 1957), quoting ***State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission et al.***, 262 U.S. 276, 288, 43 S.Ct. 544, 546, 67 L.Ed. 981, ___ (1922); see ***State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission***, 585 S.W.2d 41, 49 (Mo. banc 1979) ("Even under the file and suspend method, by which a utility's rates may be increased without requirement of a public hearing, the commission must of course consider all relevant factors including all operating expenses and the utility's rate of return, in determining that no hearing is required and that the filed rate should not be suspended.").

³⁴ *Stipulation and Agreement, In the Matter of Missouri-American Water Company's Request for Authority to Implement General Rate Increase for Water and Sewer Service Provided in Missouri Service Areas*, WR-2017-0285, filed March 1, 2018.

any NOL deferred tax asset used to offset that ADIT rate reduction would, therefore, also be considered when setting rates. Consequently, as Case No. WO-2017-0285 had a true-up cut-off date of December 31, 2017, it is completely reasonable to assume that a balance of an NOL deferred tax asset booked prior to 2018 was considered when setting MAWC's base rates, even if not explicitly stated.³⁵ As rates were set in Case No. WO-2017-0285 considering MAWC's NOL deferred tax assets accumulated prior to January 1, 2018, and those rates are still in effect, Staff contends that there would have to be an incremental increase in MAWC's ongoing NOL balances directly related to ISRS plant additions, within the applicable ISRS period, for any NOL to be eligible for inclusion in the ISRS ratemaking process since January 1, 2018.³⁶ As no incremental increase has actually occurred, a reduction of MAWC's ADIT in this case would reflect a NOL that does not actually exist. This approach would not only be contrary to the intent of the IRS Code normalization requirements, but would be squarely inconsistent with proper ratemaking principles.³⁷

Further, a reading of the entire ISRS statute makes it clear that the legislature was directing the Commission to conduct a narrow review of an application for an ISRS. Section 393.1006.2(2) specifically states that the Staff of the Commission may examine information of the water corporation to confirm that underlying costs are in accordance with the provisions of the law and to confirm proper calculation of the proposed charge. The section then states, "no other revenue requirement or ratemaking issues shall be examined."³⁸ MAWC's position that a delay in the use of prior period NOLC amounts

³⁵ Ex. 6, p. 5, Ins. 10-12; Ex. 9, p. 2, Ins. 2-7.

³⁶ Ex. 6, p. 5, Ins. 13-17.

³⁷ Ex. 7, p. 7, Ins. 11-21.

³⁸ In Re Missouri-Am. Water Co., 231 P.U.R.4th 7 (Dec. 16, 2003)

should be reflected in ISRS rates for this ISRS period not only considers costs outside of the prescribed period, but, as NOLs cannot be tied to any specific ISRS qualifying or non-ISRS qualifying infrastructure investment,³⁹ almost certainly considers NOL amounts that are in no way associated with ISRS plant. Therefore, consideration of NOLC amounts, arising from prior periods is clearly prohibited by the ISRS process outlined in statute.

The ISRS period for this proceeding extends from October 1, 2018, through March 31, 2019. Only costs directly associated with qualifying ISRS plant that went into service during those six months should be reflected in ISRS rates approved in this case. Therefore, the only potentially relevant NOL amounts in this case are those generated by MAWC from October 1, 2018, through March 31, 2019. Because MAWC's own estimates show that no NOL amount is expected to be generated during that timeframe, and because the NOL deferred tax asset balance as of year-end 2017 is currently reflected in MAWC's base rates, *no further rate treatment of that amount is appropriate in this ISRS proceeding.*

D. MAWC's NOL Calculation Methodology is Inappropriate

Given the absence of any incurred NOL amount on MAWC's books in 2018 and thus far in 2019, MAWC is actually recommending that a "hypothetical" NOL amount allegedly associated with ISRS plant additions be imputed into rate base in this case.⁴⁰ The theoretical basis for this recommendation is that the addition of ISRS plant to MAWC's rate base without immediate receipt of new revenues reduces its taxable income below the level that would result if the ISRS plant addition had not been made.

³⁹ Ex. 12, Direct Testimony of John S. Riley, p. 4, Ins. 6-8; Ex. 7, p. 3, Ins. 3-6.

⁴⁰ Ex. 8, p. 7, Ins. 17-22.

MAWC claims this delays the rate at which MAWC can utilize prior accumulated NOLs as a carry-forward against future taxable income.⁴¹ However, even ignoring the fact that consideration of NOLC amounts from prior periods is inappropriate, the methodology used by MAWC to impute a NOL amount into this ISRS period is flawed.

To represent the asserted delay in usage of past NOL carry forward amounts, the Company adds the tax timing difference related to repairs and accelerated depreciation with depreciation expense and interest expense, and then subtracts those reductions from zero. Zero represents the revenue that MAWC has yet to recover in regard to this ISRS investment.⁴² This methodology is flawed, and does not make sense for use in this proceeding. As Staff Witness Lyons explained in her direct testimony, in Missouri, utilities must place investment in-service prior to obtaining recovery in rates;⁴³ it must be used and useful.⁴⁴ If you took the approach of subtracting the incremental tax deductions associated with new ISRS plant investment from an assumed level of zero incremental revenues for the same additions, a hypothetical net operating loss amount will be calculated in every instance, whether MAWC is actually recording an NOL amount on its books or not.⁴⁵

MAWC asserts its method is appropriate, in part by claiming that deferred tax liabilities making up ADIT are just as “hypothetical” as NOL deferred tax assets.⁴⁶ However, Staff disagrees with this assessment. Deferred taxes are accounted for as an

⁴¹ Ex. 8, p. 8, Ins. 3-7.

⁴² Ex. 6, p. 4-, Ins. 9-14..

⁴³ Ex. 6, p. 4, Ins. 20-21.

⁴⁴ “The utility property upon which a rate of return can be earned must be utilized to provide service to its customers. That is, it must be used and useful. This used and useful concept provides a well-defined standard for determining what properties of a utility can be included in its rate base.” ***State ex rel. Union Electric Co. v. Public Service Commission***, 765 S.W.2d 618, 622 (Mo. App., W.D. 1988).

⁴⁵ Ex. 7, p. 2, Ins. 11-17.

⁴⁶ Ex. 1, p. 15, Ins. 12-15; Tr. P. 126.

accrual item on utility books and records.⁴⁷ Specifically, accrual accounting is used by a utility to record estimates of its deferred tax assets and liabilities on its financial reporting books; these amounts may be “trued-up” with updated information at a later date. Staff understands that MAWC records deferred tax assets and liabilities in this manner.⁴⁸ However, Staff’s contention that MAWC’s methodology creates a “hypothetical” NOL is based on the fact that its use calculates a NOL solely for purposes of this ISRS proceeding, while no such NOL deferred tax asset was actually booked by MAWC during the ISRS period.⁴⁹ Because MAWC is not generating or booking any actual NOL during this ISRS period, it is obvious that other factors are causing a situation in which MAWC has enough taxable income to “use” prior amounts of booked NOL in the ISRS period, and is not generating or booking any incremental NOL associated with ISRS plant additions that might need to be taken into account in this ISRS case.⁵⁰

It is Staff’s opinion, that should a situation arise in the future where a NOL is generated due to ISRS investment, a different method of calculation will need to be considered in order to appropriately assign a NOL to incremental ISRS investment. At a minimum, a pro rata ratio of ISRS plant additions to non-ISRS plant additions would need to be used to calculate the portion of a NOL that is reasonably attributable to ISRS plant additions.⁵¹

⁴⁷ Tr. P. 130, Ins. 2-14.

⁴⁸ Ex. 7, p. 4, Ins. 12-19.

⁴⁹ Ex. 7, p. 4, ln. 19 –p. 5, ln. 1.

⁵⁰ Ex. 6, p. 5, Ins. 3-7.

⁵¹ Ex. 7, p. 2, ln. 18 – p. 3, ln. 2.

E. Failure To Impute A Hypothetical NOL Is Not A Violation of the Normalization Rules

As stated above, MAWC argues that the theoretical reduction in taxable income allegedly caused by deductions related to ISRS plant additions made outside of a rate case somehow implicates the tax normalization requirements of the IRS Code; Staff disagrees. As explained by Staff Witness Oligschlaeger, Staff perceives the intent of the IRS Code's normalization requirements is to ensure that a utility's customers are not receiving a reduction to rate base for deferred taxes in a situation where the utility is not able to timely reflect all of its available deductions giving rise to deferred taxes on its tax return.⁵² Staff contends that its position in this case is fully consistent with this intent. Under Staff's proposed treatment of ADIT in this case, the tax benefits of accelerated depreciation associated with ISRS plant additions in this ISRS period will not be passed on to customers prematurely in a manner that violates the IRS Code. Rather, MAWC will be able to receive the benefit of the full amount of the accelerated depreciation tax deductions available to it relating to its ISRS plant additions.⁵³

Staff has found no support for MAWC's contention that failure to reflect a rate base offset for a "hypothetical" NOL in this case could lead to a normalization violation. While Treasury Regulation § 1.167(l)-1 effectively mandates that regulatory commissions normalize the benefits of accelerated tax depreciation tax deductions in setting rates, the rule clearly states that the existence of NOLs can be a relevant consideration in specific

⁵² Ex. 9, p. 7, Ins. 11-17.

⁵³ Ex. 7, p. 9, Ins. 10-21.

circumstances when assessing whether a utility is in compliance with the rules.

Section 1.167(l)-1(h)(1)(iii) states:

Except as provided in this subparagraph, the amount of Federal income tax liability deferred as a result of the use of a different method of depreciation under subdivision (i) of this subparagraph is the excess (computed without regard to credits) of the amount the tax liability would have been had a subsection (l) method been used over the amount of the actual tax liability. Such amount shall be taken into account for the taxable year in which such different methods of depreciation are used. **If, however, in respect of any taxable year the use of a method of depreciation other than a subsection (l) method for purposes of determining the taxpayer's reasonable allowance under section 167(a) results in a net operating loss carryover (as determined under section 172) to a year succeeding such taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under section 167(a) using a subsection (l) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director. (Emphasis Added).**

As explained by Staff Witness Oligschlaeger in his rebuttal testimony, the IRS Code specifies that NOLs may be relevant when assessing rule compliance in two specific situations: first, when a utility is unable to reflect all of its available accelerated depreciation tax deductions on its tax returns during a rate case period, thus creating a new NOL; and, second, when a utility's balance of an already existing NOL deferred tax asset increases due to the utility's continuing inability to reflect all available tax deductions in a rate case period.⁵⁴ However, neither of these situations applies to MAWC during this particular ISRS period. So far in 2018 and 2019, MAWC has not generated any new NOL in the aggregate, and as a result, its existing NOL balance has been decreasing, not increasing.⁵⁵

⁵⁴ Ex. 9, p. 4, Ins. 6-12.

⁵⁵ Ex. 9, p. 4, Ins. 12-15.

However, MAWC Witness Wilde contends that Section 1.167(l)-1(h)(1)(iii) “seem[s] to make it clear, the taxpayer in applying the tax normalization rules should be concerned with a deduction subject to normalization both causing a delay in the use of an existing NOLC, as well as building a new NOLC in the current period.”⁵⁶ Staff has found no support for this interpretation either in the IRS Code, or in any IRS Private Letter Ruling (“PLR”) submitted by the Company; especially in the context of a single-issue rate making mechanism such as an ISRS. Because MAWC is not currently generating any additional amount of NOL, no violation of the tax normalization rules is at risk in this case.

MAWC Witness Wilde generally referred to certain other PLRs issued by the IRS in recent years as supporting MAWC’s NOL position in this case. First of all, it is important for the Commission to understand that a PLR is based on the representations submitted by the requesting taxpayer, and is only valid if those representations are accurate. While PLRs can provide guidance, they are directed only to the taxpayer who requested it, and pursuant to 26 U.S.C.A. § 6110(k)(3) of the Federal Code, may not be used or cited as precedent. That being said, none of the PLRs discussed by Mr. Wilde, or attached to his testimony,⁵⁷ as supporting MAWC’s position are relevant to MAWC’s current financial and taxable positions. Without exception, all of the PLRs cited by Mr. Wilde address time periods in which the utility in question was generating NOL amounts,⁵⁸ and were issued in the context of general rate proceedings, or formula rate proceedings, where all relevant factors were taken into account. None of the PLRs cited as support by MAWC

⁵⁶ Ex. 1, p. 7, ln. 23 – p. 8, ln. 2.

⁵⁷ Ex. 1, Schedule JRW-1: PLR 201548017; Ex. 1, Schedule JRW-2: PLR 201718015; Ex. 1, Schedule JRW-3: PLR 201709008; Ex. 1, Schedule JRW-4: PLR 201436037; and Ex. 1, Schedule JRW-5: PRL 201519021

⁵⁸ Ex. 9, p.5, lns. 3-7; Tr. pp.94-100..

Witness Wilde appear to relate to single-issue rate proceedings similar to the ISRS process in Missouri. Again, MAWC is not currently generating any NOL; it is “using” prior amounts instead. Staff is not aware of any PLRs that directly address tax normalization consequences in the situation where a utility is utilizing, not generating, prior tax period NOL amounts.⁵⁹

However, as was discussed at hearing, concerning advice provided by the IRS, this situation might be a “case of first impression.”⁶⁰ Further, in order to obtain clarity on the issue, MAWC is currently preparing to file a PLR request with the IRS. MAWC shared a draft of its request with Staff on April 16, 2019, and Staff has provided its feedback in the form of an attachment to the PLR request, and comments as to the contents and format of the sections drafted by the Company.⁶¹ Despite MAWC’s plan to request a PLR, It is Staff’s opinion that there is no support for MAWC’s contention that Staff’s position in this case could potentially lead to a violation of the normalization requirements for accelerated depreciation benefits in the IRS Code.⁶² However, as endorsed by Staff Counsel at hearing, should there be a later determination by the IRS that Staff’s proposed treatment of imputed NOL amounts in MAWC ISRS proceedings constitutes a normalization violation, Staff would recommend the inclusion of proper amounts in rates sufficient to remedy any violation.⁶³

⁵⁹ Ex. 9, p. 5, Ins. 8-11.

⁶⁰ Tr. p. 100, Ins. 17-20.

⁶¹ Ex. 1, p. 10, Ins, 4-11.

⁶² Ex. 8, p. 9, Ins. 10-23.

⁶³ Tr. p. 26, ln. 23 – p. 27, ln. 4.

Conclusion

For the reasons set forth in this brief and Staff's Exhibits in this case, the Commission should issue an order approving Staff's recommended ISRS surcharge revenues in the incremental pre-tax revenue amount of \$8,878,845, and ordering Staff's recommended ISRS rates.

WHEREFORE, Staff respectfully submits this Post-Hearing Brief for the Commission's consideration.

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Missouri Public Service Commission

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by electronic mail, or First Class United States Postal Mail, postage prepaid, on this 24th day of May, 2019, to all counsel of record.

/s/ Mark Johnson