Exhibit No.:	_______________
Issue(s):	Exclusion of NOL in Rate Base
Witness/Type of Exhibit:	Riley/Surrebuttal
Sponsoring Party:	Public Counsel
Case No.:	WR-2020-0344

SURREBUTTAL TESTIMONY

OF

JOHN S. RILEY

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2020-0344

February 9, 2021

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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	)))))	Case No. WR-2020-0344

VERIFICATION OF JOHN S. RILEY

John S. Riley, under penalty of perjury, states:

1. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony in the above-captioned case.

2. My answer to each question in the attached surrebuttal testimony is true and correct to the best of my knowledge, information, and belief.

*/s/ John S. Riley*__________
John S. Riley, C.P.A.
Senior Utility Regulatory Auditor
Office of the Public Counsel

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SURREBUTTAL TESTIMONY

OF

JOHN S. RILEY

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2020-0344

1 **Q. What is your name and business address?**

2 A. John S. Riley, PO Box 2230, Jefferson City, Missouri 65102.

3 **Q. Are you the same John S. Riley who prepared and filed direct and rebuttal testimony in**
4 **this case on behalf of the Office of the Public Counsel?**

5 A. Yes.

6 **Q. What is the purpose of your surrebuttal?**

7 A. I will respond to the arguments presented by both Staff and MAWC witnesses who claim that
8 the balance of the Company's accumulated deferred income tax ("ADIT") should be reduced
9 by the amount of its net operating loss carryforward ("NOLC or NOL"), thereby increasing
10 rate base. Staff witness Mr. Keith Foster and Company witness Mr. John R. Wilde both
11 conclude that this practice has been accepted by the Commission in the past and therefore
12 should be accepted now. Mr. Foster and Mr. Wilde are both incorrect, however, because they
13 fail to acknowledge that the income tax expense built into rates represents interest free money,
14 that an NOL is a tax return item and has no cost, and that unused income tax expense should
15 offset the NOL. I will begin my surrebuttal by responding directly to several mistaken claims
16 made by Mr. Wilde before moving on to a general discussion of the NOL issue.

1 **Response to Specific inaccuracies in MAWC witness Wilde's rebuttal:**

2 **Q. Starting on page 4, line 18, of his rebuttal testimony, Mr. Wilde takes issue with your**
3 **general definition of ADIT as it applies to rate base and revenue requirement. Why**
4 **should the Commission disregard what Mr. Wilde says?**

5 A. Mr. Wilde spends the entire 5th page of testimony attempting to discredit my generalized
6 definition of ADIT for ratemaking purposes by arguing that I failed to address elements of the
7 ADIT calculation that were not relevant to my position or testimony. This level of hyper-
8 attention to detail is unnecessary for addressing the single, specific issue that I raised in my
9 direct. It is true that I did not engage in a line-by-line identification of every account that may
10 be involved in calculating ADIT, but that is only because I did not feel it was important to list
11 all aspects of the calculation when I was not challenging any issue other than the NOL.
12 Despite Mr. Wilde's objections, though, I note that my definition of ADIT is nearly identical
13 to the one provided by Staff witness Keith Foster is his rebuttal testimony.

14 **Q. What is Staff's working definition of ADIT for ratemaking purposes?**

15 A. Staff witness Mr. Foster provided a sound explanation of ADIT as used for ratemaking
16 purposes in his rebuttal testimony:

17 Q. Would you briefly describe what ADIT represents?

18 A. MAWC's ADIT represents, in effect, a net prepayment of
19 income taxes by customers prior to tax payment by MAWC. For
20 example MAWC is allowed to deduct depreciation expense on an
21 accelerated basis for income tax purposes, the amount of depreciation
22 expense used as a deduction for income tax purposes. This results in
23 what is referred to as a "book-tax timing difference," and creates a
24 deferral of income tax reserves to the future. The net credit balance in
25 the ADIT accounts reserve represents a source of cost-free funds to
26 MAWC. Therefore, MAWC's rate base is reduced by the ADIT
27 balance to avoid having customers pay a return on funds that are

> provided cost-free to MAWC. **Generally, deferred income taxes associated with all book-tax timing differences created through the ratemaking process should be reflected in rate base.**[1] (Emphasis added)

This definition is extremely similar to the one that I provided in direct, and which Mr. Wilde takes issue with. My only exception to Mr. Foster's definition, and Staff's position in general, is that the NOL portion of the ADIT balance should be excluded. Mr. Wilde has unfortunately decided to muddy this issue by expounding unnecessarily on an issue that no one else felt necessary to elaborate upon.

Q. On page 6, lines 1 thru 15, Mr. Wilde asserts that you mischaracterized the Company's position when you stated that "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 he correct?

A. No. Mr. Wilde is attempting to engage in some rather bizarre word-games in what appears to be an attempt to mislead the Commission. Let us take a moment to clarify and correct. The book-tax timing differences that form the core of what we generally refer to as ADIT is an example of a deferred tax liability. An NOL, by contrast, would be a deferred tax asset. Deferred tax assets and liabilities will offset one another. In this case, MAWC is seeking to offset the book-tax timing difference liability with the NOL asset, which is effectively exactly what I said in my direct testimony. The point of confusion lies with the simple fact that I used the term ADIT to refer generally to that book-tax timing difference liability, which is common practice as seen in the definition of ADIT provided by Staff witness Foster. Mr. Wilde is attempting to employ a hyper specific definition of ADIT, which he defines as the net of the book-tax timing difference liability and the NOL asset along with a variety of other timing

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[1] Keith Foster rebuttal, page 2, line 16 through page 3, line 4

1 issues. Mr. Wilde is therefore saying that you cannot offset the ADIT by the NOL because
2 the NOL is already included in the ADIT calculation. However, this is just splitting hairs. At
3 the end of the day, the only real question is whether the book-tax timing difference that forms
4 the core of the Company's ADIT should be offset by an NOL.

5 **Q. On page 6, line 16 – 18, Mr. Wilde insinuates that you have suggested that Staff excluded**
6 **the NOL from its calculation of rate base. Is this correct?**

7 A. No. My arguments with Staff calculations of rate base is that the NOL should be excluded
8 from those calculations, which Staff has not done.[2]

9 **Q. On page 7, lines 6 thru 8, Mr. Wilde states: "Mr. Riley suggest the company's tax**
10 **expense is accrued without regard to the NOL, and therefore the NOL DTA was over-**
11 **collected from customers." How do you respond to this statement?**

12 A. I never argued there was an "over-collection" – or even used that term – and I have absolutely
13 no idea what Mr. Wilde is referring to. In fact, I am not sure how an NOL, an income tax
14 return item, can ever be "over collected" unless the utility incorrectly calculates its tax liability
15 when it remits its tax return. Mr. Wilde and I are in complete agreement, however, with his
16 statement that "[t]he deferral of tax resulting from the acceleration or deferral of a tax
17 deduction has no impact on the customers' tax expense."[3] In fact, this forms the underlying
18 basis of my entire argument. The IRS requires that, for ratemaking purposes, income tax
19 expense must be calculated without regard for the tax timing differences.[4] This is the basis
20 of setting aside the deferred income tax (*i.e.* ADIT) into a reserve account. Even with the

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[2] I do argue that the CWC portion of rate base should be reduced for the unspent income tax expense but that argument was limited to rebuttal testimony.
[3] Wilde, Rebuttal pg. 7 lines 9 – 10.
[4] Statute **168(i)(9)(A)(i)**

1 ADIT taken into consideration, however, the Company is still expected to pay income taxes
2 and is therefore still allotted an amount of current income tax expenses in its revenue
3 requirement. The balance of the **current** portion of income tax expense built into rates is far
4 greater than the amount of deferred tax, but not all of this expenses is actually needed to pay
5 income taxes because of several tax deductions available to the Company. As a result, the
6 income tax expense built into the rates approved by the Commission is higher than what the
7 Company actually pays when it remits its tax returns. Because income tax expense is built
8 into rates, but not spent, these funds effectively form a second pool of interest free money for
9 the Company to use; one that is separate and distinct from the ADIT balance in the deferred
10 tax account. The existence of an NOL does not in any way prohibit or prevent the Company
11 from making use of this second pool of interest free money. Again, the money is already built
12 into rates as current income tax expense and is going to be collected from customers but then
13 not used to pay income taxes.

14 **Q. On page 8, lines 12 thru 18, of his rebuttal testimony, Mr. Wilde claims that eliminating**
15 **the entire NOL, protected and unprotected, would result in a normalization violation.**
16 **Would this be true?**

17 A. No. MAWC is always quick to raise the specter of a "*normalization violation*" so as to instill
18 fear into the Commission and Staff, but Mr. Wilde offers no real substance to support this
19 claim. Instead, he simply asserts that the IRS has "consistently" ruled this way. This is
20 provably wrong. Consider, for example, the article titled *Determining whether a utility's*
21 *ratemaking treatment of an NOL carryforward complies with the normalization requirements*
22 written by one Mr. David Yankee, partner at Deloitte Tax LLP, and attached as exhibit JSR-
23 S-01. The article notes that the IRS found the decision of a public service commission that
24 excluded an NOL from rate base calculations was not a violation of the normalization rules
25 in PLR 201418024. Specifically, the article states as follows:

1 > The taxpayer in PLR 201418024 incurred taxable losses in excess of taxable income over a multiyear period and as of its test year had an NOL carryforward and a minimum tax credit (MTC) carryforward (attributable to the rule limiting utilization of alternative minimum tax NOL carryforwards to 90% of alternative minimum taxable income). The amount of accelerated depreciation claimed in the two loss years exceeded the amount of NOLs incurred in those years. The utility filed a general rate case with plant-based DTL balances reduced by the amounts of tax not deferred due to the NOL and MTC carryforwards. The commission issued an order with rates based on DTL balances unreduced by the effects of the carryforwards. In its analysis, the IRS stated that there is little guidance on exactly how an NOL or MTC carryforward must be taken into account in calculating DTLs pursuant to the normalization requirements, but it is clear that both must be taken into account for ratemaking purposes. The ruling indicates that the commission has stated that in setting rates it included a provision for deferred taxes based on the entire difference between accelerated tax and regulatory depreciation, including situations in which a utility had an NOL or MTC carryforward. This approach is described as allowing a utility to collect amounts from ratepayers equal to income taxes that would have been due absent the NOL and MTC carryforwards. The IRS accepted these commission assertions as true for purposes of the ruling, did not conclude that the commission had actually set rates in accordance with the assertions, and indicated that the assertions are subject to verification on audit. The IRS held that reduction of rate base by the full amount of the DTL account without regard to the balances of the NOL and MTC carryforward accounts was consistent with the normalization requirements because the commission already took the carryforwards into account in setting rates.

28 Again, the important takeaway from this article is that the IRS found the commission decision to exclude the NOL balances is acceptable because rates were set on an included amount of income tax expense built into the cost of service**. This scenario is nearly exactly how this Commission sets rates in a general rate case.** The NOL had already been accounted for in rates by way of included income tax expense and there is no need to make an adjustment for a company's NOLC. The conclusions drawn in this PLR indicates that an NOL and credits must be addressed when setting rates; however, the IRS found that recognition of income tax in rates that would equal the expected amount, without a downward adjustment for prior tax losses, was acceptable.

I have included the PLR itself as JSR-S-02 along with the testimony that I have previously written directly on this subject as filed in ER-2018-0145 (JSR-S-03).

General Response to Underlying Argument of Company and Staff:

Q. Can you summarize the general response of Company and Staff?

A. Staff witness Foster provides a summary of Staff's position in case ER-2019-0374 at page 3 ln 19 thru page 4 line 5 of his rebuttal testimony:

> As described above, an ADIT is meant to offset tax liability and generate "cost-free funds." But, to the extent a utility's taxable income becomes negative due to eligibility of large tax deductions, including bonus depreciation, there is no amount of income tax liability available for the excess deductions to offset and, therefore, no "cost-free funds" for the utility are generated associated with that excess amount. In this situation, the utility must record an offsetting deferred tax asset for NOL. As mentioned above "[g]enerally, deferred income taxes associated with all book-tax timing differences created through the ratemaking process should be reflected in rate base." This includes recognition of a deferred tax asset for NOLs when an NOL situation arises for a regulated utility.

Based on the remainder of this rebuttal testimony, I believe that this represents a good summary of the position taken by Staff and the Company in this case as well.

Q. What is your general response to the Staff and Company Position?

A. The principal problem with the position is that they neglect to consider the current income tax expense that is already included in MAWC's revenue requirement. Before I go any further, let me explain the difference between "income tax liability" and "income tax expense." Income tax expense is the expense built into a utility's revenue requirement based on what the utility is expected to pay in income tax. In other words, it is the money that the utility is permitted to collect from customers to pay its income taxes. This income tax expense can be further subdivided into "current income tax expense," which is what is expected to be paid in the upcoming tax year, and "deferred income taxes," which are taxes that are collected from customers now but whose payment has been deferred to some future period. Income tax

liability, on the other hand, is what the utility is *actually* liable to pay to the federal government in income taxes in each year. In other words, it is the amount that the utility actually pays in taxes.

Now let us bring things back around to the position of Staff and Company. First, note that Staff states "ADIT is meant to offset tax liability and generate 'cost-free funds.'" It is important to note that when Staff states that ADIT is used to create "cost-free funds" that is referring exclusively to the deferred income tax expense that is already built into the Company's revenue requirement. This has no effect on the "current income taxes" as I pointed out in my direct.[5] It is extremely important to understand that even with ADIT, the Company is still expected to pay income taxes, which is why it has a current income taxes expense section and a deferred income tax section broken out in Staff accounting schedule: 09. (Schedule JSR-S-04)

Next, let us focus on the following line from Mr. Fosters' rebuttal: "to the extent a utility's taxable income becomes negative due to eligibility of large tax deductions, including bonus depreciation, there is no amount of income tax liability available for the excess deductions to offset and, therefore, no 'cost-free funds' for the utility are generated associated with that excess amount." This statement is categorically wrong because it ignores the unspent **current** income tax expense built into rates. The key to understanding this case comes with understanding that, in the situation being described, the excess deductions are offsetting the existing **current** income tax expense, thus creating a second **new** pool of interest free money. This is because the Company has collected the current income tax expense from customers but, due to the excess deductions, will not remit it to the government. This unspent current

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[5] Riley direct, page 4, lines 3-8

1 income tax expense is the cost-free funds that should be used to offset the NOL, which the
2 Staff is attempting to argue does not exist.

3 **Q. How much interest free money has MAWC generated?**

4 A. More than $28 million has been included in the Company's prior rate cases[6] as an annual
5 income tax expense. As I explained in both my direct testimony and rebuttal testimony
6 concerning cash working capital ("CWC"), however, the Company has not paid federal
7 income tax in over three years[7] and paid very little Missouri state income in the same
8 timeframe. As such, the more than $28 million in current income tax expenses built into
9 MAWC's revenue requirement has never been actually realized by the Company, who has
10 instead been allowed to keep this money, interest free.[8] That is over $84 million of interest
11 free money in a three year period. Moreover, this huge quantity of interest free money has
12 never been recognized by the Commission as a rate base item. This is a huge yet unnoticed
13 regulatory tax advantage that would otherwise be unavailable to the Company were it not a
14 regulated utility.

15 **Q. Could you explain this regulatory tax advantage and why it would not be available if**
16 **MAWC was not a regulated utility?**

17 A. The simple answer is just that a private (*i.e.* unregulated) company does not have access to
18 this same source of interest free money. An unregulated business competes in the economy,
19 and if it does it well enough, it makes a profit. Generally, when a business makes a profit it
20 pays income taxes. But those taxes are not paid out of a pot of predefined "current income

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[6] $28 million is derived from Staff original revenue requirement, Accounting Schedule 1, line 8 "Current Income Tax Available"

[7] A review of American Water Works tax returns provided for past rate cases indicates that it has not paid federal income tax for 10 years.

[8] WR-2017-0285, Staff original accounting schedule 1

1 tax expense." Instead, those taxes are paid out of the profits the unregulated company has
2 generated. Now, compare this to the regulated utility, which is afforded a predetermined
3 revenue requirement. The regulated utility gets both a pre-determined return on its investment
4 (the equivalent of profit for the unregulated business) **and** a pre-determined amount of money
5 to use to pay income taxes (current income tax expense). The point of this comparison is that,
6 while the unregulated business generally may take advantage of tax timing differences just
7 like a regulated utility, when it creates an NOL the only advantage it gains is that it no longer
8 has to pay taxes. The regulated utility by contrast, not only avoids having to pay taxes but
9 also gets to keep the pile of money that was previously earmarked for tax payment for free.
10 In short, customers are effectively paying a regulated utility extra whenever it manages to
11 escape tax liability. This creates a clear regulatory tax advantage over the unregulated business
12 that may get to keep more of its profits but does not get the added benefit of being paid extra
13 for not paying taxes.

14 **Q. You previously mentioned that an NOL is a tax return item. How should the**
15 **Commission treat a tax return item?**

16 A. A tax return item is a function of tax code application. Assets have a measureable cost.
17 Depreciation is an allocation of that cost. Just because the IRS has allowed a different cost
18 allocation that creates an NOL does not mean that an NOL has a cost. It is not an asset that
19 has a cost. Staff and Company witnesses argue that the Commission has previously allowed
20 NOL to increase rate base and therefore profit to the Company, but this is fundamentally
21 wrong. As a tax return item, an NOL has no cost and is not amortized. Allowing this
22 adjustment would amount to requiring the ratepayers of MAWC to pay an ROR of 6.33%[9] on

[9] Using Staff's Mid-Point ROR range

1 $51+ million of assets that have no cost. If the Commission does not correct this fundamental
2 error, a tax return item will cost the consumer over $4.2 million in revenue requirement.[10]

3 **Q. Mr. Wilde makes an argument on page 8 of his rebuttal testimony that excluding the**
4 **NOL, whether it is the entire NOL or just the unprotected portion, would be "contrary**
5 **to established practice in base rate cases where the full NOL has consistently been**
6 **included."[11] Is that a correct statement?**

7 A. While I concede that the Commission has permitted inclusion of an NOL in the past, that does
8 not mean the practice should continue. As can be seen from the testimony I have included as
9 attachment JSR-S-03, I've argued this concept for several years with most rate cases being
10 settled without a decision. The Commission only considered the argument in the case Mr.
11 Foster mentioned in his rebuttal: Case No. ER-2019-0374. Unfortunately my argument in that
12 case was not as detailed as it should have been, which lead the Commission to basing its
13 decision on erroneous information and findings of fact.

14 **Q. What erroneous information are you referring to?**

15 A. First, as I have already discussed, in the regulatory arena, **income tax liability** and **income**
16 **tax expense** represent two entirely different accounting components. Understanding the
17 difference should assist the Commission in recognizing why income tax expense is interest
18 free money and how that fact negates any argument for NOL inclusion. Let us turn to the
19 Report and Order from ER-2019-0374, and, in particular, consider fact number 260 where the
20 terminology is confused:

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[10] This is an uncomplicated calculation of $51 million multiplied by the Staff midpoint ROR of 6.33% and then grossed up for taxes ($3,228,300 X 1.313027)=$4,238,845

[11] Wilde, rebuttal, page 8 lines 21 and 22.

1 2 3 4

> 260. If the use of accelerated tax depreciation reduces **current income tax expense** to a negative number, a NOL results. NOLs are carried forward to possible offset future current income tax expense and cash outflows.[12] (Emphasis added)

5 The proper wording here should have been: **"If the use of accelerated tax depreciation**
6 **reduces current *income tax liability* to a negative number . . . ."** This is important because
7 income tax expense does not get reduced in the revenue requirement even though there is no
8 taxable income. As I pointed out earlier, the Company had the use of approximately $84
9 million in income tax expense since the last rate case yet none of that amount went to federal
10 income tax and very little went to Missouri state income tax.

11 Let's look at the next error in the decision. To quote:

12 13 14

> "The NOL offsets the ADIT liabilities. This is appropriate since the NOL did not reduce current income tax payments and did not provide the company with a no-cost source of capital"[13]

15 This is plainly wrong. The NOL did provide the company a source of no-cost capital by way
16 of the unreduced income tax expense built into rates. The Company in ER-2019-0374 had
17 millions worth of income tax expense included in its revenue requirement that it simply did
18 not have to pay to the federal government. A portion of that unspent income tax expense **was**
19 the no-cost source of capital created by the NOL.

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[12] This was cited from Ex. 5, Richard Rebuttal Page 8

[13] ER-2019-0374, R&O last line of page 89 and lines 1, 2 of page 90.

1 **Q. Are there any other facts that the Commission should consider when determining the**
2 **NOL eligibility for MAWC in this case?**

3 A. Yes. MAWC proposed a future test year for revenue requirement consideration. While the
4 OPC continues to oppose the future test year concept, it should be noted that MAWC had no
5 NOL adjustment in its future test year.

6 **Q. Why did the Company leave an NOL out of rate base calculations?**

7 A. In the Company response to OPC data request 1302, which is included as schedule JSR-S-05,
8 MAWC points out that the NOL balance was not expected to exist in the proposed future test
9 year.

10 **Q. How will this acknowledgement affect the revenue requirement?**

11 A. The Commission needs to be cognizant of the fact that this NOL is a short-term phenomenon
12 whose life does not have an amortization in this case. This $51 million is a proposed rate base
13 increase that will not be around for the expected period these rates will be in effect.

14 **Q. Could you please summarize your arguments for denying a rate base adjustment for the**
15 **tax return generated NOL?**

16 A. Yes. The Company is not hindered from its use of the interest free ADIT by the recognition
17 of an NOL. Recognizing an NOL as an asset that reduces rate base even though no cost can
18 be assigned to it, is asking the ratepayer to pay twice. Once as a ROR on the $51 million NOL
19 and then again for the interest free money provided by the income tax expense that does not
20 get paid to the taxing authority.

21 **Q. Does this conclude your surrebuttal testimony?**

22 A. Yes.

Deloitte.

Determining whether a utility's ratemaking treatment of an NOL carryforward complies with the normalization requirements

Situation presented

Many utilities have incurred net operating losses (NOLs) in recent years due to bonus depreciation, favorable section 481(a) adjustments, or general economic conditions. The proper treatment of the resulting NOL carryforward under the normalization requirements has been the subject of numerous ratemaking proceedings.

On May 2, 2014, the Internal Revenue Service (IRS) released Private Letter Ruling (PLR) 201418024 regarding the treatment of deferred tax assets (DTAs) for NOL carryforwards under the deferred tax normalization requirements of Treas. Reg. § 1.167(1)-1(h)(1)(iii). PLR 201418024 held that not including the NOL carryforward DTA in rate base, the methodology advocated by the public utility commission, complied with the normalization requirements in a specific circumstance.

On September 5, 2014, the IRS released PLR 201436037 and PLR 201436038, holding that failure to take into account the portion of an NOL carryforward that is attributable to accelerated depreciation in calculating the amount of a deferred tax liability (DTL) in the computation of rate base would be inconsistent with the normalization requirements and further, that any method for determining the portion of the NOL carryforward attributable to accelerated depreciation other than the "with and without" method would be inconsistent with the normalization requirements. On September 19, 2014, the IRS released PLR 201438003 providing guidance consistent with the other two rulings issued in September. The methodologies held to comply with the normalization requirements in the more recent rulings were the methodologies advocated by the utilities.

Issue

The methodology that was held to comply with the normalization requirements in PLR 201418024 results in a lower revenue requirement than (1) the alternatives advocated by and approved for many utilities in their rate cases and (2) the approaches held to comply with the normalization requirements in the limited number of NOL-related PLRs released in prior years. This ruling may create regulatory risk in pending and future rate cases for other utilities with NOL carryforwards.

Utilities may need to demonstrate that the rationale underlying the methodology in PLR 201418024 is inapplicable in their factual situations if not universally arguing that it simply is an inappropriate manner of analyzing the recovery of regulatory tax expense, notwithstanding the holdings of the recent three rulings

that did not indicate that the factors or rationale of PLR 201418024 are relevant in applying the normalization requirements for NOL carryforwards.

Background

Treas. Reg. § 1.167(1)-1(h)(1)(iii) provides that if an NOL carryforward would not have arisen (or increased), but for the use of accelerated tax depreciation, 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. This rule recognizes that depreciation-related DTLs are interest-free loans from the government extended via the reduction of current tax liability due to the use of accelerated tax depreciation, and should not reduce the rate base (or, depending on the ratemaking mechanics used by the regulator, reduce the weighted-average cost of capital) unless the depreciation-related DTLs result in a reduction of cash taxes (i.e., serve as a source of funding). This tax rule is consistent with the economics of ratemaking, but is not as prescriptive as most of the deferred tax normalization requirements and does not provide examples of specific methodologies that comply with or violate the rules. Instead, the rule effectively directs utilities to obtain private letter rulings to determine whether their public utility commissions' ratemaking treatments of depreciation-related DTLs, while in an NOL carryforward position, comply with the normalization requirements.

Prior to the 2014 ruling, the IRS had issued one PLR regarding the application of the normalization rules to NOL carryforwards and two PLRs regarding the application of the normalization rules to NOL carrybacks. The three rulings addressed fact patterns involving carryovers to tax years with different statutory tax rates than the tax rates in effect in the years the NOLs were generated, a dynamic not present in rate cases in recent years.

In PLR 8818040, the IRS held that the regulations provide that the amount of deferred taxes subject to the normalization rules in a year an NOL is generated is computed using a "with-and-without" methodology (i.e., deferred taxes equal the excess of taxes due without accelerated depreciation over the taxes due with accelerated depreciation) and using the tax rate effective for the year the tax deferral is realized. The net effect of this accounting in the NOL years was to record no deferred taxes applicable to the amount of accelerated depreciation that produced no current tax savings (i.e., that caused or increased the NOL carryforward). The IRS further ruled that the DTL should not be recorded for ratemaking purposes until 1987, the year in which the utility benefitted from the NOL attributable to accelerated depreciation, and at the tax rate effective for 1987 (i.e., 39.95 % rather than the 46% tax rate effective for 1985 and 1986, the years the NOLs were generated). The taxpayers did not request guidance on alternative methodologies and the ruling did not address the proration methodology that was analyzed in the 1989 and 1993 rulings summarized below.

In PLR 8903080, the utility incurred an NOL in a tax year with a tax rate of 39.95%, estimated for ratemaking purposes that it would incur an NOL in a tax year with a 34% rate and carried back the NOLs to tax years with tax rates of 46% for purposes of determining ratemaking deferred taxes. For each NOL year, the utility recorded a total tax provision (i.e., sum of the current and deferred tax provisions) at the tax rate in effect for the year in which each NOL was generated (i.e., 39.95% or 34%, respectively). The current tax benefits of the years the NOLs were generated were measured at the 46% tax rates applicable to the years to which the NOL carrybacks were deducted. In each year an NOL was generated, the deferred tax expense attributable to the book-tax timing differences was recorded at a tax rate in excess of the statutory tax rates in effect for the years the NOLs were generated (as well as in excess of the enacted tax rates of the future tax years when the timing differences were expected to reverse). The tax rate differential as a result of the NOL carrybacks to the higher rate tax year was allocated pro rata to all timing items for the years the NOLs were generated. The IRS held that recording a total tax provision at the current year's statutory tax rate for each year an NOL was generated is appropriate and is consistent with the normalization requirements of Treas. Reg. § 1.167(1)-1(h)(1)(iii). This ruling also indicated that the methodology complied with the normalization requirements applicable to excess deferred income taxes under section 203(e) of the Tax Reform Act of 1986. The methodology described above was the only approach analyzed in the ruling.

In PLR 9336010, the utility incurred an NOL in a tax year with a 34% tax rate and carried back the loss to a year with a 46% tax rate. For financial reporting purposes, the utility recorded deferred taxes for all timing differences originating in the year the NOL was generated at the 34% tax rate applicable to such year (and future years). Commission staff recommended that for ratemaking purposes deferred taxes be recorded at the 46% tax rate applicable in the carryback years and that an excess DTL reducing rate base be created. The commission adopted the staff's recommendation and ordered the utility to seek a private letter ruling to determine the amortization method and period related to the excess tax reserve resulting from the interaction of the reduction in corporate

Schedule JSR-S-1
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income tax rates and the NOL carryback. The utility and commission staff asserted that none of the excess tax reserve resulting from the NOL carryback resulted from the use of accelerated depreciation. The IRS disagreed and concluded that the taxpayer had not shown which particular items caused the NOL and, thus, the appropriate methodology to allocate the excess tax reserve among timing differences originating in the year the NOL was generated is a pro rata allocation to all timing differences. The IRS held that a portion of the excess deferred tax reserve resulting from the NOL carryback is attributable to the timing difference for accelerated depreciation and that only this portion of the excess tax reserve is subject to the normalization requirements for excess deferred taxes. There was no detailed discussion on exactly how the pro rata allocation was to be effectuated by the taxpayer in this ruling.

The taxpayer in PLR 201418024 incurred taxable losses in excess of taxable income over a multiyear period and as of its test year had an NOL carryforward and a minimum tax credit (MTC) carryforward (attributable to the rule limiting utilization of alternative minimum tax NOL carryforwards to 90% of alternative minimum taxable income). The amount of accelerated depreciation claimed in the two loss years exceeded the amount of NOLs incurred in those years. The utility filed a general rate case with plant-based DTL balances reduced by the amounts of tax not deferred due to the NOL and MTC carryforwards. The commission issued an order with rates based on DTL balances unreduced by the effects of the carryforwards. In its analysis, the IRS stated that there is little guidance on exactly how an NOL or MTC carryforward must be taken into account in calculating DTLs pursuant to the normalization requirements, but it is clear that both must be taken into account for ratemaking purposes. The ruling indicates that the commission has stated that in setting rates it included a provision for deferred taxes based on the entire difference between accelerated tax and regulatory depreciation, including situations in which a utility had an NOL or MTC carryforward. This approach is described as allowing a utility to collect amounts from ratepayers equal to income taxes that would have been due absent the NOL and MTC carryforwards. The IRS accepted these commission assertions as true for purposes of the ruling, did not conclude that the commission had actually set rates in accordance with the assertions, and indicated that the assertions are subject to verification on audit. The IRS held that reduction of rate base by the full amount of the DTL account without regard to the balances of the NOL and MTC carryforward accounts was consistent with the normalization requirements because the commission already took the carryforwards into account in setting rates.

The taxpayer and its consolidated group in PLR 201436037 incurred or expected to incur NOLs resulting in NOL carryforwards. The taxpayer computed the depreciation-related portion of its DTA on a with-or-without methodology whereby the NOL carryforward was considered attributable to accelerated depreciation to the extent of the lesser of the amount of accelerated depreciation or the NOL carryforward. Other approaches were proposed by other rate case participants, including a proposal to reduce regulatory tax expense by the amount of the DTA determined to be attributable to accelerated depreciation. The IRS stated that regulations make clear that the effects of an NOL carryforward attributable to accelerated depreciation must be taken into account in determining the rate base reduction for DTLs for normalization purposes, but that the regulations provide no specific mandate on methods. The IRS stated that the with-or-without methodology provides certainty regarding correctly taking into account the depreciation-related portion of the DTA for an NOL carryforward and the prevention of the possibility of flow-through of the benefit of accelerated depreciation to ratepayers by maximizing the amount of the NOL carryforward attributable to accelerated depreciation. The IRS ruled that, under the circumstances presented, reduction of rate base by the full amount of the DTL account balances offset by a portion of the DTA for the NOL carryforward that is less than the amount attributable to accelerated depreciation computed on a with-or-without basis would be inconsistent with the normalization requirements. Further, any reduction to tax expense included in cost of service to reflect the tax benefit of an NOL carryforward would be inconsistent with the normalization requirements because such reduction would, in effect, flow through the tax benefits of accelerated depreciation deductions through to ratepayers even though the taxpayer had yet to realize the benefits.

Similarly, the taxpayer and its consolidated group in PLR 201436038 incurred or expected to incur NOLs resulting in NOL carryforwards. The taxpayer computed the depreciation-related portion of its DTA on a with-or-without methodology whereby the NOL carryforward was considered attributable to accelerated depreciation to the extent of the lesser of the amount of accelerated depreciation or the NOL carryforward. Other approaches were proposed by other rate case participants. The IRS stated that regulations make clear that the effects of an NOL carryforward attributable to accelerated depreciation must be taken into account in determining the rate base reduction for DTLs for normalization purposes, but that

the regulations provide no specific mandate on methods. The IRS stated that the with-or-without methodology provides certainty regarding correctly taking into account the depreciation-related portion of the DTA for an NOL carryforward and the prevention of the possibility of flow-through of the benefit of accelerated depreciation ratepayers by maximizing the amount of the NOL carryforward attributable to accelerated depreciation. The IRS ruled that, under the circumstances presented, reduction of rate base by the full amount of the DTL account balances offset by a portion of the DTA for the NOL carryforward that is less than the amount attributable to accelerated depreciation computed on a with-or-without basis would be inconsistent with the normalization requirements.

The utility subsidiary in PLR 201438003 forecasted that it would incur an NOL resulting in an NOL carryforward in its test period. The utility reduced its DTL used to reduce rate base by the amount of the DTA for the NOL carryforward. The utility's commission issued an order holding that it was inappropriate to include the DTA for the NOL carryforward in rate base, but stating that it intended to comply with the normalization requirements and that it would allow the utility to seek an adjustment to rates if it obtains a private letter ruling affirming the utility's position that failure to reduce its rate base offset for depreciation-related DTL by the DTA attributable to the NOL carryforward would be inconsistent with the normalization requirements. The IRS stated that regulations make clear that the effects of an NOL carryforward attributable to accelerated depreciation must be taken into account in determining the rate base reduction for DTLs for normalization purposes, but that the regulations provide no specific mandate on methods. The IRS stated that the with-or-without methodology employed by the utility provides certainty regarding correctly taking into account the depreciation-related portion of the DTA for an NOL carryforward and the prevention of the possibility of flow-through of the benefit of accelerated depreciation to ratepayers by maximizing the amount of the NOL carryforward attributable to accelerated depreciation. The IRS ruled that, under the circumstances presented, reduction of rate base by the full amount of the DTL account balance unreduced by the balance of the DTA for the NOL carryforward would be inconsistent with the normalization requirements. The IRS also ruled that use of a balance for the portion of the DTA for the NOL carryforward attributable to accelerated depreciation that is less than the amount computed on a with-and-without basis would be inconsistent with the normalization requirements. The IRS also held that assignment of a zero rate of return to the balance of the DTA for the NOL carryforward attributable to accelerated depreciation would be inconsistent with the normalization requirements.

Implications

The economic and regulatory debate regarding the proper treatment of DTAs for NOL carryforwards in ratemaking involves acknowledgment that recorded DTLs resulting from enacted tax incentives, such as accelerated depreciation intended to stimulate the economy, essentially represent interest-free loans from the government to taxpayers, regardless of the industry of the taxpayer or how the taxpayer sets its prices. The interest-free loan only occurs if or to the extent the corresponding deductions result in reduction (deferral) of tax payments to the government. This does not occur when the deductions for accelerated depreciation result in or contribute to an NOL carryforward.

The normalization debate regarding the proper treatment of DTAs for NOL carryforwards in ratemaking may involve:

- Whether the full amount of the depreciation-related DTL may reduce rate base despite the existence of an NOL carryforward (i.e., whether the DTA for the portion of an NOL carryforward attributable to accelerated depreciation must be included in rate base);
- How to compute the depreciation-related portion of a DTA for an NOL carryforward; and
- Consideration of alternative approaches to reduce the revenue requirement when an NOL carryforward exists and some or all of the DTA for the NOL carryforward is included in rate base.

The IRS has exercised the discretion granted to it by the normalization regulations to assess whether the specific methodologies arising in rate cases and presented in five private letter ruling requests involving NOL carryforwards comply with the normalization requirements. The alternatives and arguments of the parties to the rate proceedings have varied in the private letter rulings issued in this area.

In PLR 201418024, the only private letter ruling on these matters resulting from a ruling request that did not seek guidance regarding use of the with-or-without methodology, the IRS instead considered a perspective presented that focused on whether the utility had recovered through rates charged amounts that compensated it for deferred tax expense attributable to depreciation deductions that had not yet resulted in savings of cash taxes in the current year or a carryback year. Whether this factor is relevant is questionable and how to determine whether this condition exists is challenging. Without explaining how to determine whether this ratemaking condition exists, the IRS held in PLR 201418024 that there is a ratemaking approach that

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complies with the deferred tax normalization requirements yet permits not reducing depreciation-related DTLs due to the existence of an NOL or MTC carryforward.

In light of the analysis and holding of PLR 201418024, utilities may need to evaluate whether they have recovered depreciation-related deferred tax expense from ratepayers when NOL carryforwards have been incurred or are expected to recover depreciation-related deferred taxes from ratepayers when NOL carryforwards are forecasted. Utilities without tax adjustment clauses (i.e., "trackers") or without true-up mechanisms with regard to allowed earnings may have difficulty establishing whether or not they have actually recovered the amount of income taxes inherent in their revenue requirement or the portions of their actual revenues attributable to regulatory income tax expense. Any such analysis should also address whether it is possible or appropriate to evaluate whether a single component of regulatory tax expense (i.e., depreciation-related deferred tax expense) has been recovered through rates without regard to the other components of the tax provision (e.g., other components of the deferred tax provision, the current tax provision, investment tax credit (ITC) amortization). In analyzing the application of the facts and assumptions of PLR 201418024 to their rate situations, utilities will likely need to assess whether the income tax components of their revenue requirements in their most recent rate cases (or their actual revenues during the years NOLs were generated) are determined with reference to allowed equity returns, actual equity returns, book-tax differences, or other factors. It would also be worthy to note whether the depreciation-related portion of deferred tax expense exceeds the total or net tax provision (in light of the current tax benefit likely recorded in an NOL year).

The factor analyzed in PLR 201418024 was not mentioned in the other four NOL carryforward normalization letter rulings. In the other four private letter rulings, the IRS consistently held that the maximum depreciation-related DTL that is allowed to reduce rate base must consider the existence of an NOL carryforward and that the depreciation-related portion of the DTA for the NOL carryforward included in rate base must be computed with reference to a with-or-without approach (sometimes referred to as a with-and-without approach in the rulings).

The IRS has also ruled that two alternative approaches proposed by parties to rate proceedings seeking to reduce revenue requirements when an NOL carryforward exists would violate the normalization requirements. These alternatives were proposed to mitigate or eliminate the effect of inclusion of a DTA related to an NOL carryforward in rate base reduction of recoverable tax expense by an amount equal to the deferred tax benefit associated with the DTA, and treatment of the DTA as zero-cost capital. Utilities should continue to assert economic, ratemaking, and tax normalization defenses against similar assertions that aim to circumvent the effects of the normalization requirements.

Lastly, it should be noted that there are a number of other pending ruling requests regarding the application of the normalization requirements to NOL carryforwards that will afford the IRS additional opportunities to provide guidance on this important issue.

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Internal Revenue Service

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Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B06
PLR-133813-13

Date:
January 27, 2014

LEGEND:

Taxpayer =

Parent =

State =
Commission =
Year A =
Year B =
Year C =
Year D =
Year E =
X =
Y =
Date A =
Date B =
Date C =
Date D =
Date E =
Case =
Director =

Dear . :

This letter responds to the request, dated July 30, 2013, of Taxpayer for a ruling on whether the Commission's treatment of Taxpayer's Accumulated Deferred Income

Tax (ADIT) account balance in the context of a rate case is consistent with the requirements of the normalization provisions of the Internal Revenue Code.

The representations set out in your letter follow.

Taxpayer is a regulated public utility incorporated in State. It is wholly owned by Parent. Taxpayer distributes and sells natural gas to customers in State. Taxpayer is subject to the regulatory jurisdiction of Commission with respect to terms and conditions of service and particularly the rates it may charge for the provision of service. Taxpayer takes accelerated depreciation where available and, for the period beginning in Year A and ending in Year E, Taxpayer has, in the aggregate, produced more net operating losses (NOL) than taxable income. After application of the carryback and carryforward rules, Taxpayer represents that it has net operating loss carryforward (NOLC), produced in Year C and Year E, of $X as of the end of Year E. The amount of claimed accelerated depreciation in Year C and Year E exceeded the amount of the NOLCs for those years. In Year D, Taxpayer produced regular taxable income as well as alternative minimum taxable income (AMTI); the regular taxable income was offset by the NOLCs from Year B and year C but could not offset the entire alternative minimum tax (AMT) liability due to the limitation in § 56(d). Taxpayer paid $Y of AMT in Year D and had a minimum tax credit carryforward (MTCC) as of the end of year E of $Y.

On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account and also maintains an offsetting series of entries that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of an NOLC. With respect to the $Y AMT liability from Year D, Taxpayer carried that amount as an offset to the ADIT because the AMT increased the payment of tax.

Taxpayer filed a general rate case on Date A (Case). The test year used in the Case was the 12 month period ending on Date B. In establishing the income tax expense element of its cost of service, the tax benefits attributable to accelerated depreciation were normalized in accordance with Commission policy and were not flowed thru to ratepayers. In establishing the rate base on which Taxpayer was to be allowed to earn a return Commission generally offsets rate base by Taxpayer's plant based ADIT balance, using a 13-month average of the month-end balances of the relevant accounts. Taxpayer argued that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of

NOLCs or the AMT. Commission, in an order issued on Date C, did not use the amounts that Taxpayer calculates did not defer tax due to NOLCs or AMT but only the amount in the ADIT account. Taxpayer filed a petition for reconsideration based on the normalization implications of the order. On Date D, Commission rejected Taxpayer's request. Taxpayer again requested reconsideration and the Commission denied that request on Date E. Commission asserts that, in setting rates it includes a provision for deferred taxes based on the entire difference between accelerated tax and regulatory depreciation, including situations in which a utility has, such as in this case, an NOLC or AMT. Thus, Commission asserts that it has already recognized the effects of the NOCL in setting rates and there is no need to reduce the ADIT by the other amounts due to NOLCs or AMT.

Taxpayer requests that we rule as follows:

Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account without regard to the balances in its NOLC-related account and its MTCC-related account was consistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.

Law and Analysis

Section 168(f)(2) of the Code provides that the depreciation deduction determined under section 168 shall not apply to any public utility property (within the meaning of section 168(i)(10)) if the taxpayer does not use a normalization method of accounting.

In order to use a normalization method of accounting, section 168(i)(9)(A)(i) of the Code requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that-would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under section 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under section 168(i)(9)(A)(ii), unless such estimate or projection is

also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.

Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a “normalization method of accounting.” A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(1)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under section 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer’s use of different depreciation methods for tax and ratemaking purposes.

Section 1.167(1)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the 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 (1) method for purposes of determining the taxpayer’s reasonable allowance under section 167(a) results in a net operating loss carryover 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 (1) 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.

Section 1.167(1)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under section 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to

reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under section 1.167(1)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under section 167(a).

Section 1.167(1)-(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under section 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.

Section 1.167(1)-(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under section 1.167(1)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

Section 55 of the Code imposes an alternative minimum tax on certain taxpayers, including corporations. Adjustments in computing alternative minimum taxable income are provided in § 56. Section 56(a)(1) provides for the treatment of depreciation in computing alternative minimum taxable income. Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.

Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so. Section 1.167(1)-(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Section 56(a)(1)(D) provides

that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.

In the rate case at issue, Commission has excluded from the base to which the Taxpayer's rate of return is applied the reserve for deferred taxes, unmodified by the accounts which Taxpayer has designed to calculate the effects of the NOLCs and MTCC. There is little guidance on exactly how an NOLC or MTCC must be taken into account in calculating the reserve for deferred taxes under §§ 1.167(1)-1(h)(1)(iii) and 56(a)(1)(D). However, it is clear that both must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT) for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.

Both Commission and Taxpayer have intended, at all relevant times, to comply with the normalization requirements. Commission has stated that, in setting rates it includes a provision for deferred taxes based on the entire difference between accelerated tax and regulatory depreciation, including situations in which a utility has an NOLC or MTCC. Such a provision allows a utility to collect amounts from ratepayers equal to income taxes that would have been due absent the NOLC and MTCC. Thus, Commission has already taken the NOLC and MTCC into account in setting rates. Because the NOLC and MTCC have been taken into account, Commission's decision to not reduce the amount of the reserve for deferred taxes by these amounts does not result in the amount of that reserve for the period being used in determining the taxpayer's expense in computing cost of service exceeding the proper amount of the reserve and violate the normalization requirements. We therefore conclude that the reduction of Taxpayer's rate base by the full amount of its ADIT account without regard to the balances in its NOLC-related account and its MTCC-related account was consistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above. In particular, while we accept as true for purposes of this ruling Commission's assertions that it includes a provision for deferred taxes based on the entire difference between accelerated tax and regulatory depreciation, including situations in which a utility has an NOLC or AMT, we do not conclude that it has done so and those assertions are subject to verification on audit.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your

authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
(Passthroughs & Special Industries)

cc:

REBUTTAL TESTIMONY

OF

JOHN S. RILEY

KANSAS CITY POWER & LIGHT COMPANY
CASE NO. ER-2018-0145

KCP&L GREATER MISSOURI OPERATIONS COMPANY
CASE NO. ER-2018-0146

1 **Q. What is your name and what is your business address?**

2 A. John S. Riley, PO Box 2230, Jefferson City, Missouri 65102.

3 **Q. By whom are you employed and in what capacity?**

4 A. I am employed by the Missouri Office of the Public Counsel ("OPC") as a Public Utility
5 Accountant III.

6 **Q. Are you the same John S. Riley that filed direct testimony in this case?**

7 A. Yes, I am.

8 **Q. What is the purpose of your rebuttal testimony?**

9 A. The purpose of my testimony is to address the inclusion of net operating loss carryforwards
10 in the rate base calculations of both Kansas City Power & Light Company ("KCPL") and
11 KCP&L Greater Missouri Operations Company ("GMO") as presented in the direct testimony
12 of Ronald A. Klote. The inclusion of NOLC in the rate base to offset accumulated deferred
13 income tax ("ADIT") represents an incorrect discount to ADIT and therefore inflates the rate
14 base. OPC also notes that Staff's accounting schedules reflect ADIT balances with net
15 operation loss ("NOL") amount reductions.

16 I will also respond to KCPL and GMO proposals to include a five year amortization of NOLC
17 in the cost of service. I will point out that a NOL should not be included in the cost of service
18 at all but if the Commission accepts the Companies' argument for inclusion, the amortization

1 should follow the same timeframe of the ADIT payback period that corresponds with the
2 NOL.

3 Finally, I respond to Staff's witness Mathew Young use of inflated short-term natural gas
4 prices in its fuel run and recommend normalized pricing that avoids the inclusion of a price
5 spike.

6 **RATE BASE AND COST OF SERVICE EXCLUSION OF NOLC**

7 **Q. What is a net operating loss?**

8 A. Simply put, a net operating loss is where a company has more expenses than revenues in a
9 given tax year. I refer to a tax year because regulated utilities do not normally experience
10 financial losses but can show a loss for tax purposes.

11 **Q. Could you explain how a utility incurs a tax loss but does not experience a financial loss?**

12 A. Companies are allowed to take advantage of accelerated depreciation for tax purposes. This
13 is especially advantageous for a capital intensive utility. For example, an asset that costs
14 $1,000 can be placed into service that has a useful life of 20 years. In calculating depreciation
15 for ratemaking purposes, the depreciation is $50 a year for 20 years ($1,000 divided by 20
16 years). For tax purposes the asset can be depreciated over 5 years so tax depreciation is $200
17 a year for five years. For tax purposes, the depreciation expense is $150 more than for
18 ratemaking. This increase expense can lower taxable income to the point that the company
19 shows a loss on its income tax return. Yet for ratemaking purposes, the expenses are much
20 lower (just $50) and the company generates a $150 profit over the first five years. This "loss"
21 is allowed to be carried back two years and applied to past taxable income and any remaining
22 balance may be "carried over" to the next year's tax return and applied to the taxable income[1].
23 If the losses are large enough in size that it may be applied to several years into the future,

[1] IRS Publication 542

1 then the Company would have established a net operating loss carryforward ("NOLC") for
2 tax purposes. The tax rate applied to the difference between the $50 that is used for
3 ratemaking and the $200 use for tax purposes is a tax timing difference. For that reason, taxes
4 are deferred.

5 **Q. Is this deferral of tax owed by the Company what is referred to as accumulated deferred**
6 **income tax or ADIT?**

7 A. That is correct. Taking advantage of accelerated depreciation, as described above, over the
8 course of many years and the purchase of many assets builds up a large tax timing difference.

9 **Q. How is ADIT treated in the ratemaking process?**

10 A. ADIT is basically the difference between the tax expense that a company is allowed in the
11 cost of service and the lower amount of taxes a company actually pays because of the
12 depreciation savings. This is considered interest free money to the utility so for ratemaking
13 purposes, the rate base that is used to set rates is reduced by the amount of ADIT to reflect the
14 advantage the interest free money is afforded the company. It stands to reason that if the
15 ratepayer is subsidizing (contributing cost free funds) KCPL and GMO for income tax
16 expense then it certainly should not be subjected to an offsetting NOL amortization in either
17 rate base or the cost of service.

18 **Q. Does accelerated depreciation always create a NOL?**

19 A. No, but the use of accelerated depreciation for tax purposes and the use of straight line
20 depreciation for ratemaking always creates a deferred income tax. Accelerated depreciation
21 can sometimes result in an income tax loss, but just because a utility can claim a loss does not
22 mean it has a legitimate asset for regulatory purposes. A NOL should not be an item that has
23 any bearing on the rate base or cost of service of a utility because a NOL is a fictitious asset
24 and does not exist in the regulatory environment but only in the income tax return.

1 **Q. Please explain how a NOLC is a fictitious asset?**

2 A. KCPL and GMO show a NOL on its section of Great Plains Energy's consolidated tax return.
3 GMO had hundreds of millions of tax losses on its books when GPE purchased GMO. GPE
4 2016 10-K states:

5 **Net Operating Loss Carryforwards**
6 At December 31, 2015 and 2014, Great Plains Energy had $656.1
7 million and $521.0 million, respectively, of tax benefits related to
8 federal net operating loss (NOL) carryforwards. Approximately
9 $313.2 million at December 31, 2015 and 2014 are tax benefits
10 related to NOLs that were acquired in the GMO acquisition[2].
11
12 The Companies have built up enough NOL that all of the tax losses cannot be fully utilized in
13 one year. The Companies argue that since it cannot take advantage of the full operating loss
14 in one tax year then it should offset the ADIT rate base adjustment, which is a liability, with
15 a fictitious NOL regulatory asset (a carryforward) thereby raising rate base. Utilities have
16 pressed this argument for years and some commissions have accepted the claim but the logic
17 is a fallacy. Let's explain:

18 Income tax expense has been included in rates every year and ratepayers have been paying
19 this expense even though KCPL and GMO have not actually paid any taxes. Taxes are
20 reflected in rates but a NOL is not paid for (not an added cost) to the company and does not
21 affect the cost of service. So to have the Companies insist on the inclusion of a fictitious
22 regulatory asset that it did not pay for is in a sense double recovery from ratepayers. Having
23 a NOLC offset for ADIT is asking the ratepayer to pay twice.

24 **Q. Are there any other publications that the Commission should consider when disallowing**
25 **a NOL in the rate base or amortizing it in the cost of service?**

[2] Page 107 of Great Plains Energy 2016 10-K financial reporting

1 A. Yes. The attached IRS private letter rulings ("PLR") (Schedule JSR-R-1) regarding similar
2 circumstances as the present case and also the attached article published by Deloitte[3]
3 (Schedule JSR-R-2) that illustrates the PLR and other factors in casting doubt on whether a
4 NOL should be considered for rate base or amortization. A pertinent paragraph from the
5 Deloitte article which paraphrases important information within the PLR that addresses NOL
6 exclusion follows:

7 The taxpayer in PLR 201418024 incurred taxable losses in excess
8 of taxable income over a multiyear period and as of its test year had
9 an NOL carryforward and a minimum tax credit (MTC)
10 carryforward (attributable to the rule limiting utilization of
11 alternative minimum tax NOL carryforwards to 90% of alternative
12 minimum taxable income). The amount of accelerated depreciation
13 claimed in the two loss years exceeded the amount of NOLs incurred
14 in those years. The utility filed a general rate case with plant-based
15 DTL balances reduced by the amounts of tax not deferred due to the
16 NOL and MTC carryforwards. The commission issued an order with
17 rates based on DTL balances unreduced by the effects of the
18 carryforwards. In its analysis, the IRS stated that there is little
19 guidance on exactly how an NOL or MTC carryforward must be
20 taken into account in calculating DTLs pursuant to the
21 normalization requirements, but it is clear that both must be taken
22 into account for ratemaking purposes. **The ruling indicates that the
23 commission has stated that in setting rates it included a
24 provision for deferred taxes based on the entire difference
25 between accelerated tax and regulatory depreciation, including
26 situations in which a utility had an NOL or MTC carryforward.
27 This approach is described as allowing a utility to collect
28 amounts from ratepayers equal to income taxes that would have
29 been due absent the NOL and MTC carryforwards.** The IRS
30 accepted these commission assertions as true for purposes of the
31 ruling, did not conclude that the commission had actually set rates
32 in accordance with the assertions, and indicated that the assertions
33 are subject to verification on audit. The IRS held that reduction of
34 rate base by the full amount of the DTL account without regard to
35 the balances of the NOL and MTC carryforward accounts was
36 consistent with the normalization requirements because the

[3] Article contacts are David Yankee, a partner in Deloitte Tax LLP and Brad Seltzer, a principle in Deloitte Tax LLP

1 commission already took the carryforwards into account in setting
2 rates.[4] (Emphasis Added)
3
4 The IRS found the commission decision to exclude the NOL balances is acceptable because
5 rates were set on an included amount of income tax expense built into the cost of service. This
6 scenario is nearly exactly how this Commission sets rates in a general rate case. The NOL
7 had already been accounted for in rates by way of included income tax expense and there is
8 no need to make an adjustment for a company's NOLC. The conclusions drawn in this PLR
9 indicate that NOL and credits must be addressed when setting rates; however, the IRS found
10 that recognition of income tax in rates that would equal the expected amount, without a
11 downward adjustment for prior tax losses, was acceptable.

12 **Q. What is the level of income tax expense Staff has included in the cost of service for each**
13 **of these companies?**

14 A. The proposed Income Statement that Staff has prepared for KCPL in Accounting Schedule
15 09 indicates that the Missouri jurisdictional income tax included in the calculations for the
16 cost of service is $38,209,633. The GMO accounting schedule 09 page 1 has $43,698,933
17 included in the cost of service for income taxes.

18 **Q. How long may KCPL and GMO carry a loss forward for income tax purposes?**

19 A. Currently losses may be carried back two years and carried forward 20 years, however, losses
20 generated after December 31, 2017 do not have an expiration and may be carried forward
21 indefinite.

22 **Q. What adjustment is OPC proposing so a NOLC is eliminated from rate base calculations**
23 **for KCPL?**

---

[4] Deloitte, "Determining Whether a Utility's Ratemaking Treatment of an NOL Carryforward Complies with the Normalization Requirements" Page 3 second paragraph
DTL stands for Deferred Tax Liability

1 A. Neither Companies nor Staff eliminate NOLC from the ADIT amounts they include in rate
2 base. Using the answers to Staff data request 0239 and 0190, KCPL displays a Federal and
3 State total plant[5] NOL as a federal $171,777,252 and state of $22,332,049 for a combined
4 reduction from rate base of $192,742,994. Company workpapers filed with the case indicate
5 that KCPL had $175,734,901 in federal NOL and $15,953,843 in state NOL built into its case.
6 OPC is seeking a $192,742,994 reduction in rate base. These numbers may be updated when
7 KCPL provides true-up information in the next few weeks.

8 **Q. What is OPC adjustment for NOLC in GMO's rate base?**

9 A. In the same data requests used for KCPL, both 0190 and 0239 indicate that GMO carries a
10 $128,258,446 NOL balance within its deferred income tax accounts. The Company included
11 workpapers in the case that indicated a total NOL of $129,870,221 OPC is requesting a
12 reduction to rate base of this amount.

13 **COMPANIES REQUESTS FOR A FIVE YEAR AMORTIZATION OF A NOLC**

14 **Q. The Companies have proposed a five (5) year amortization of its NOLC to offset the**
15 **amortization of the excess deferred income tax calculations that are built into the cost of**
16 **service in these cases.[6] How do you respond to this proposal?**

17 A. OPC disagrees with this proposal and offers three points of contention on why this should be
18 denied. First, as explained previously in this testimony, a NOL does not belong in the
19 calculation of rate base within a utility rate case. NOLs are fictitious assets due in part that
20 ratepayers have incurred income tax expense in rates and the Companies have not paid income
21 taxes to the IRS. The amortization of a NOL in rates is double recovery and results in a
22 punitive action towards the ratepayer where it has already subsidized income tax expense that

[5] The Company's use of the word "plant" in the description of KCPL's NOL will be revealing when OPC argues that a five your amortization violates normalization rules.
[6] KCPL response to Data Request MECG3-5(f)

1 is not earmarked for actual income taxes paid. Since the NOLC should not be considered as
2 an offset to ADIT, there is no need to amortize the account.

3 Secondly, neither Company has identified any portion of its ADIT or NOL in its records as
4 being created due to unregulated subsidiaries. Both Companies have several unregulated
5 subsidiaries. I have pointed out earlier that GMO had millions of tax losses to carryforward
6 when GPE purchased them. Much of GMO's prior business (Aquila) was risky and
7 unregulated. Unregulated subsidiary tax advantages need to be excluded from the regulated
8 business. If any portion of ADIT or NOL is due to unregulated subsidiaries, this portion
9 would need to be identified and separated to provide an accurate cost of service. I am
10 continuing to search for unregulated portions of ADIT and NOL because the Companies'
11 direct filing failed to include competent and substantial evidence to show what portion of the
12 ADIT or NOL is due to unregulated operations.

13 Lastly, should the Commission allow the inclusion of a NOL amortization within these cases,
14 then the amortization period <u>must</u> follow the IRS required Average Rate Assumption Method
15 (ARAM) that guides the flow back of the protected ADIT portion. ARAM is an amortization
16 method that flows the excess deferred tax over the remaining life of each asset. The NOL will
17 be subject to the same rate. The Companies' recommendations to the Commission violates
18 the amortization methods. It stands to reason that if ARAM will be used to determine the
19 amortization of the protected portion of the excess ADIT, then the NOL attributable to that
20 protected portion must also flow back at the same pace. The NOL must flow back at the same
21 rate as the associated ADIT. If any portion of the excess deferred is unprotected then it should
22 offset at the same rate as the unprotected amortization.

1 **NORMALIZED NATURAL GAS PRICES FOR THE STAFF FUEL RUN**

2 **Q. Have you reviewed the fuel costs used by Staff to determine the fuel costs as sponsored**
3 **by Matthew Young?**

4 A. Yes. I reviewed the natural gas costs used in the Staff's fuel run.

5 **Q. Are the natural gas prices used by Staff reflective of a normalized fuel cost?**

6 A. No. The natural gas prices used by Staff for the months of May and August for KCPL are
7 not reflective of a normalized fuel cost. In particular, OPC is concerned regarding the
8 natural gas price of $9.31 used in the month of August.

9 **Q. Is this a reasonable cost to estimate natural gas cost for the month of August?**

10 A. No. The table below shows the prices used for KCPL for July, August and September
11 along with the Henry Hub prices. (Gas prices and graph are attached as JSR-R-3)

	KCPL		Henry Hub
July	$3.17		$2.99
August	**$9.31**		$2.90
Sept	$3.47		$2.98

12
13 **Q. What is the effect of using a $9.31 price for natural gas?**

14 A. The model will not dispatch the natural gas units because the cost with a $9.31 price is not
15 cost-effective given the market prices. Therefore, KPCL's natural gas units, including the
16 combined cycle unit at Hawthorn that would be typically be in the money during summer
17 peak months, were not modeled as running. This resulted in either more purchased power
18 from the SPP market to meet KCPL's load or less off-system sales margin because the
19 units were considered too expensive.

1 **Q. What is your recommendation for the Commission?**

2 A. I recommend the Commission order Staff to estimate fuel costs using a normalized natural
3 gas cost instead of the actual natural gas price in its modeling of fuel costs.

4 **Q. Does this conclude your direct testimony?**

5 A. Yes, it does.

Missouri-American Water Company
Case No. WR-2020-0344
Total Company EMS
Test Year Ending 12-31-2019
Income Statement Detail

Line Number	A Account Number	B Income Description	C Test Year Total (D+E)	D Test Year Labor	E Test Year Non Labor	F Adjust. Number	G Total Company Adjustments (From Adj. Sch.)	H Total Company Adjusted (C+G)	I Jurisdictional Allocations	J Jurisdictional Adjustments (From Adj. Sch.)	K MO Final Adj Jurisdictional (H x I) + J	L MO Adj. Juris. Labor	M MO Adj. Juris. Non Labor
												L + M = K	
124	722.000	Pumping Labor & Expenses	$0	$0	$0	E-124	$0	$0	0.00%	$0	$0	$0	$0
125	724.000	Miscellaneous Expense	$393	$0	$393	E-125	$0	$393	100.00%	$0	$393	$0	$393
126	725.000	Rent	$0	$0	$0	E-126	$0	$0	0.00%	$0	$0	$0	$0
127		TOTAL PUMPING OPERATIONS EXPENSES	$4,901	$0	$4,901		$0	$4,901		-$25	$4,876	$0	$4,876
128		PUMPING MAINTENANCE EXPENSES											
129	730.000	Maint. Supervision & Engineering	$0	$0	$0	E-129	$0	$0	0.00%	$0	$0	$0	$0
130	731.000	Maint. Of Structures & Improvements	$630	$630	$0	E-130	$0	$630	100.00%	-$696	-$66	-$66	$0
131	732.000	Maint. Of Power Production Equipment	$2,715	$708	$2,007	E-131	$0	$2,715	100.00%	-$708	$2,007	$0	$2,007
132		TOTAL PUMPING MAINTENANCE EXPENSES	$3,345	$1,338	$2,007		$0	$3,345		-$1,404	$1,941	-$66	$2,007
133		TREAT. & DISP. OPER. EXPENSE											
134	740.000	Operation - Supervision & Engineering	$59	$59	$0	E-134	$0	$59	100.00%	-$59	$0	$0	$0
135	741.000	Chemicals	$49,926	$0	$49,926	E-135	$0	$49,926	100.00%	-$15,007	$34,919	$0	$34,919
136	742.000	Operation Labor & Expense	$897,500	$866,555	$30,945	E-136	$0	$897,500	100.00%	$59,713	$957,213	$925,988	$31,225
137	743.000	Miscellaneous Expenses - TDO	$1,777,980	$0	$1,777,980	E-137	$0	$1,777,980	100.00%	$420,183	$2,198,163	$0	$2,198,163
138	744.000	Miscellaneous Expense - TDO	$132,738	$0	$132,738	E-138	$0	$132,738	100.00%	-$187,907	-$55,169	-$186,508	$131,339
139	745.000	Rents - TDO	$3,709	$0	$3,709	E-139	$0	$3,709	100.00%	$11,829	$15,538	$0	$15,538
140		TOTAL TREAT. & DISP. OPER. EXPENSE	$2,861,912	$866,614	$1,995,298		$0	$2,861,912		$288,752	$3,150,664	$739,480	$2,411,184
141		TREAT. & DISP. MAINT. EXPENSES											
142	750.000	Maint. Supervision & Engineering - TDM	$0	$0	$0	E-142	$0	$0	0.00%	-$1,364	-$1,364	-$1,364	$0
143	751.000	Maint. Of Structures & Improvements - TDM	$0	$0	$0	E-143	$0	$0	0.00%	$0	$0	$0	$0
144	752.000	Maint. Of Water Treatment Equipment	$244,510	$52,237	$192,273	E-144	$0	$244,510	100.00%	$265,969	$510,479	$20,535	$489,944
145		TOTAL TREAT. & DISP. MAINT. EXPENSES	$244,510	$52,237	$192,273		$0	$244,510		$264,605	$509,115	$19,171	$489,944
146		TOTAL OPERATING EXPENSE	$207,903,812	$74,820,858	$85,627,281		$0	$207,903,812		-$11,757,317	$196,146,495	$66,318,067	$74,562,592
147		NET INCOME BEFORE TAXES	$116,710,869	$0	$0		$0	$116,710,869		$9,354,578	$126,065,447	$0	$0
148		INCOME TAXES											
149	409.100	Current Income Taxes	-$10,407,247	See note (1)	See note (1)	E-149	See note (1)	-$10,407,247	100.00%	$39,393,021	$28,985,774	See note (1)	See note (1)
150		TOTAL INCOME TAXES	-$10,407,247	$0	$0		$0	-$10,407,247		$39,393,021	$28,985,774	$0	$0
151		DEFERRED INCOME TAXES											
152	410.100	Deferred Income Taxes - Def. Inc. Tax.	$31,764,307	See note (1)	See note (1)	E-152	See note (1)	$31,764,307	100.00%	-$30,490,606	$1,273,701	See note (1)	See note (1)
153	412.200	Amortization of Deferred ITC	-$103,620			E-153		-$103,620	100.00%	$0	-$103,620		
154	0.000	Amortization of Protected Excess ADIT	$0			E-154		$0	0.00%	-$3,006,185	-$3,006,185		
155	0.000	Amortization of Unprotected Excess ADIT	$0			E-155		$0	0.00%	-$20,325,863	-$20,325,863		
156		TOTAL DEFERRED INCOME TAXES	$31,660,687	$0	$0		$0	$31,660,687		-$53,822,654	-$22,161,967	$0	$0
157		NET OPERATING INCOME	$95,457,429	$0	$0		$0	$95,457,429		$23,784,211	$119,241,640	$0	$0

JSR-S-4

DATA INFORMATION REQUEST
Missouri-American Water Company
WR-2020-0344

Requested From: Brian LaGrand
Date Requested: 8/26/2020

Information Requested:

NOL in rate base - Please provide the NOL balances that Company proposes to include in rate base for this case. Please break-out NOL by protected and unprotected balances. Also separate NOL into actual and future test year balances.

Requested By: John Riley - Office of Public Counsel – john.riley@opc.mo.gov

Information Provided:

The following table provides the gross NOLC outstanding as of 12/31/2019 used for year end tax provision purposes, which will be updated in a later filing when the tax return is completed. 2020 activity and balances will be provided in as scheduled to be updated.

A NOL DTA was not originally included in the ADIT balance used to computed rate base for this case, as it was prepared assumed the Company would be using a future test year in which the Company did not expect to be carrying an NOLC. Given a historic test year of 2019 updated for 2020 is now being used, it would be appropriate economically and pursuant to the tax normalization rules to include the NOLC DTA carried by the Company during the test year.

EADIT remains a component of ADIT included in rate base until normalized/amortized.

For the purpose of responding to this data request the Company used the with and without method to determine which portion of the of the NOLC balance is protected and which portion of the NOLC balance was unprotected. The DTA related to the Federal NOLC for historical test year of 12/31/2019 is $20.9M of ADIT and $22.8M of EADIT, of that $24.7M is protected and $19.1M is unprotected. The State NOL DTA is $7.2M, which is all unprotected.

	Gross	ADIT	EADIT	Total Regulatory ADIT
Federal NOL	99,969,600	20,993,616	22,817,238	43,810,854
	Protected			
	68,746,758	14,436,819	10,293,171	24,729,990
	Unprotected			
	31,222,842	6,556,797	12,524,067	19,080,864
State NOL	**Unprotected**			
		2,069,616	5,166,647	7,236,263

Responsible Witness: John WIlde