BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Petition of Missouri-American Water Company for Approval to Change its Infrastructure System Replacement Surcharge (ISRS)	))))	**File No. WO-2020-0190**

MAWC BRIEF

COMES NOW Missouri-American Water Company ("MAWC" or "Company"), and, as its *Brief*, states as follows to the Missouri Public Service Commission ("Commission"):

TABLE OF CONTENTS

GENERAL RESPONSE TO OPC ALLEGATIONS

In its testimony and opening statement, the Office of the Public Counsel ("OPC") has turned what is essentially a difference of opinion as to the handling of the net operating loss ("NOL") issues associated with an Infrastructure System Replacement Surcharge ("ISRS") and tax normalization requirements into an occasion for accusations and name calling.

There is no misrepresentation by MAWC in its request to the Internal Revenue Service ("IRS") for a Private Letter Ruling ("PLR"). OPC just does not like that the IRS has a different view of NOL within the context of tax normalization.

The primary dispute OPC seems to have is that MAWC identifies a NOL in regard to the ISRS period in question in the request. In OPC's view, there cannot be a NOL where on a tax year basis income is sufficient to reduce the company's NOL carry over ("NOLC"). **[1]

[1] Ex. 102C, Wilde Dir., Sch. JRW-1, pp. 18-19 of 134.
[2] Ex. 102C, Wilde Dir., Sch. JRW-1, p. 19 of 134.

[TABLE]

**

The resulting PLR recognized as follows:

> For year 2, Parent (on a consolidated basis) and Taxpayer (on a separate company basis) estimate that taxable income was earned and, thus, NOLC was utilized.[3]

_____.[4] The PLR recognized the Commission's decision as follows:

> Differing assertions were made as a part of the Surcharge Case. Ultimately the Commission in its final order determined that because there was not an NOL expected to be generated in Year 4, no portion of the NOLC deferred tax asset can be associated with the Surcharge property.[5]

The PLR further included a description of the Surcharge case.[6]

Finally, the Commission Staff was given the opportunity to review the request, did review the request, provided comments that were included with the request, and indicated its belief that the request was adequate and complete.[7]

[3] Ex. 102C, Wilde Dir., Sch. JRW-2, p. 7 of 23 (language was included in the publicly available PLR).
[4] Ex. 102C, Wilde Dir., Sch. JRW-1, pp. 57-67 of 134.
[5] Ex. 102C, Wilde Dir., Sch. JRW-2, p. 9 of 23 (language was included in the publicly available PLR).
[6] Ex. 301, Oligschlaeger Reb., p. 5.

The real issue as to the existence of a NOL as it applies to these ISRS cases is that the IRS does not define NOL for normalization purposes in the same way as OPC. Staff witness Oligschlaeger accurately observed as follows:

> I think as has been discussed at great length both in testimony here today, the IRS appears to have a different working definition of NOL in the context of ISRS rate cases than Staff or OPC in the past.[8]

Mr. Oligschlaeger further stated that "the IRS . . . has effectively taken a broader view that anytime a company has a pre-existing NOL on its books, even if it's being used and no additional amounts are being generated would trigger ruling number 9."[9]

An outcome that the OPC does not like, does not equal "false representations to the IRS,"[10] "false information,"[11] a "false scenario,"[12] or a "false set of facts"[13] as OPC described the situation. As can be seen above, the situation was accurately and thoroughly described by MAWC's request to the IRS, to include the fact that MAWC would have taxable income in the subject year absent the application of NOLC, submission of the Commission's decision in File No. WO-2018-0373, and submission of the Commission Staff's comments. OPC's casual use of the above inflammatory phrases for what is merely a disagreement about the application of federal tax normalization rules is helpful neither to the regulatory process nor to the public's perception of that process.

---

[7] Ex. 103P, Wilde Reb., pp. 5-6; Ex. 301, Oligschlaeger Reb., p. 7.
[8] Tr. 118, Oligschlaeger.
[9] Tr. 123, Oligschlaeger.
[10] Tr. 27.
[11] Ex. 202, Riley Reb., p. 3.
[12] *Id*.
[13] *Id*. at p. 8.

ISSUE 1

1. **Should MAWC's incremental pre-tax revenue requirement in this matter include a total of $35,328 associated with MAWC's proposal to address alleged normalization violations related to eligible infrastructure system replacements included in MAWC's currently effective ISRS?**

The $35,328 adjustment to the incremental pre-tax revenue requirement referenced by this issue should be approved in order to cure, at the "next available opportunity," a normalization issue identified in a Private Letter Ruling ("PLR") MAWC received from the Internal Revenue Service ("IRS").

BACKGROUND

MAWC's last three ISRS cases (Files Nos. WO-2018-0373, WO-2019-0184, and WO-2019-0389) concerned an issue related to a potential tax normalization violation associated with accumulated deferred income taxes and the reflection of a net operating loss ("NOL") within the ISRS. The ADIT issue included both accelerated depreciation and a repairs allowance used by the Company.

Files Nos. WO-2018-0373 and WO-2019-0184 were litigated before the Commission. In File No. WO-2018-0373, the Commission found as follows in denying MAWC's proposed adjustment related to NOL:

> 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.[14]

In File No. WO-2019-0184, the Commission found as follows in denying reflection of the NOL proposed by MAWC:

> MAWC is expected to continue utilizing prior NOL carryovers to offset its taxable income in 2018 and 2019, but will not generate a new NOL in the aggregate, although it already has had four months where its carryover NOL amount increased for that month. As MAWC is expected to have taxable income in 2018 and 2019, it is reasonable to conclude that MAWC is not generating an NOL during the ISRS Period. MAWC also seems to argue that apart from the NOL carryover, it experiences an NOL every time it invests in ISRS plant up until the ISRS rate for that ISRS plant is implemented and collected.
>
> On the contrary, the record indicates that NOLs are not specifically tracked as to origin. The record also indicates that an NOL is an accounting item, not a regulatory item, and that it is a term encompassing an annual or longer period. The record further shows that prior instances of NOL are addressed in full rate cases, as MAWC's pre-December 2017 NOL was addressed in its most recent full rate case.
>
> Since the IRS Private Letter Rulings only address periods where an NOL is generated, and none involve single-issue ratemaking, there is no legal support for MAWC's position that an exclusion of an NOL would violate normalization requirements of the IRS Code.
>
> The Commission, for the reasons discussed herein, finds there is *not sufficient evidence* to show an NOL being generated in the ISRS Period.[15]

The Commission based its decisions in Files Nos. WO-2018-0373 and WO-2019-0190 on MAWC's failure to carry its burden of proof in those cases. Specifically, the Commission explained that in its view MAWC's failure primarily related to: 1) the expectation that MAWC would have taxable income in the relevant years prior to application of net operating loss carry over amounts; and, 2) that the PLRs MAWC produced for consideration by the Commission in those PLRs did not involve single-issue ratemaking.

[14] Report and Order, p. 7, File No. WO-2018-0373 (December 5, 2018) (emphasis added).
[15] Report and Order, p. 12, File No. WO-2019-0184 (June 5, 2019) (emphasis added).

The PLR received by MAWC in December of 2019 that is the subject of this case addresses each of those issues. The PLR concerns:

1) MAWC specifically;
2) Normalization requirements within the context of a single-issue ratemaking proceeding (this ISRS); and,
3) Specifically contemplates that MAWC will generate taxable income in the relevant tax year prior to the application of net operating loss carryovers.[16]

The IRS ruled that the reflection of a full deduction of applicable accelerated depreciation amounts without an offset for a net operating loss (or NOL) in computing the ISRS surcharge constituted a violation of the IRS Code's normalization provisions.[17]

This was a possibility recognized by both the Commission and the Court of Appeals. The Court of Appeals stated, in part, as follows in regard to MAWC's appeal of the Commission's WO-2019-0184, after being informed of the existence of the PLR:

> Actual financial impact on the company (including impact associated with purported violations of IRS normalization rules) that is supported by substantial evidence, and calculated appropriately, may be eligible for consideration in a future ISRS rate case, or at a minimum will be eligible for consideration in Missouri-American's next general rate case.[18]

Thus, MAWC seeks to cure the identified violation associated with the accelerated depreciation. That request is supported by the Staff of the Commission and opposed by the Office of the Public Counsel.

---

[16] "For year 2, Parent (on a consolidated basis) and Taxpayer (on a separate company basis) estimate that taxable income was earned and, thus, NOLC was utilized." Ex. 102C, Wilde Dir., Sch. JRW-2, p. 7 of 23; *See also* Ex. 102C, Wilde Dir., Sch. JRW-1, pp. 18-19 of 134.

[17] The IRS, however, ruled that there was no normalization violation associated with the Commission's reflection of the repair allowance amounts without offset.

[18] *In the Matter of the Petition of Missouri-American Water Company et al.*, p. 16, Case No. WD83067 (April 21, 2020) (emphasis added).

NORMALIZATION

In most situations, while a state utility regulatory commission is aware of tax impacts, it would not be required to treat taxes in any particular manner from a ratemaking standpoint. However, as Staff witness Oligschlaeger stated in his testimony in Case No. WO-2018-0373:

> . . . in regard to the specific timing differences associated with use of accelerated depreciation methods for tax purposes, the IRS Code effectively mandates that regulatory commissions normalize the benefits of the accelerated depreciation tax deductions in setting rates. If the regulatory commissions do not allow for such normalization treatment, that action could result in loss of the entire accelerated depreciation deduction by the utility.[19]

Mr. Oligschlaeger went on to correctly comment that "[i]n essence, the tax normalization requirements of the IRS Code mandate that utility rates be set so that customers do not receive the tax benefit of accelerated depreciation deductions any faster than over the estimated straight-line book lives authorized for the utilities' assets."[20]

TERMS

A tax loss results when tax deductions during the relevant period exceed taxable income recognized during the same period. A tax loss can be measured and refer to a specific transaction, subset set of transactions such as an ISRS, or all transactions executed during that same period.[21]

A net operating loss ("NOL") results when tax deductions during the relevant period exceed taxable income recognized during the same period. The distinction between tax loss and net operation loss depends on the transactions you choose to net operating results for. For example, ISRS plant transactions during a relevant period could result in a tax loss, but when

[19] Ex. 102P, Wilde Dir., p. 4-5; See Ex. 300, Oligschlaeger Dir., pp. 3-4.
[20] Ex. 102P, Wilde Dir., p. 4-5.
[21] Ex. 103P, Wilde Reb., p. 6.

combined with other transactions during the same relevant period could produce a net operating gain or loss depending on the relevant facts and circumstances at the time.[22]

A net operating loss carryover ("NOLC") is the balance of NOL tax deductions available to a taxpayer at the end of a given period that exceed the amount of taxable income recognized that would allow those tax deductions to be utilized. The NOLC balance is carried forward to be claimed when the taxpayer is out of a NOL position, having sufficient income to use all of its available deductions.[23]

PLR PROCESS

Soon after December 5, 2018, the date the Commission ruled in File No. WO-2018-0373, MAWC began the process of pursuing a PLR from the IRS. On a parallel path, MAWC attempted to remedy the situation through its appeals of Files Nos. WO-2018-0373 and WO-2019-0184, and an agreement concerning an Accounting Authority Order that was approved by the Commission in File No. WO-2019-0389.[24] MAWC's request for a PLR was filed with the IRS on June 5, 2019, and supplemented thereafter on June 6, 2019.[25]

MAWC utilized Deloitte and a nationally known expert on normalization rules (Dave Yankee) to represent the Company as to the PLR.[26] The Staff of the Commission was involved in this filing process. On April 16, 2019, MAWC provided the Staff a draft of the PLR request for review and comment. This interaction with the Commission is a required step before MAWC could file the PLR request. Revenue Procedure 2019–1 contains requirements related to PLR's concerning normalization. Specifically, it states in relevant part, "A letter ruling request that

[22] *Id*. at pp. 6-7; *See* Ex. 300, Oligschlaeger Dir., p. 5; *See* Ex. 100, para. 13-14.
[23] Ex. 103P, Wilde Reb., p. 7.
[24] Ex. 102P, Wilde Dir., p. 8.
[25] Ex. 102P, Wilde Dir., p. 9.
[26] Tr. 51, Wilde.

involves a question of whether a rate order that is proposed or issued by a regulatory agency will meet the normalization requirements of §168(f)(2) (pre-Tax Reform Act of 1986, §168(e)(3)) and former §§46(f) and 167(l) ordinarily will not be considered unless the taxpayer states in the letter ruling request whether—

> (1) the regulatory authority responsible for establishing or approving the taxpayer's rates has reviewed the request and believes that the request is adequate and complete; and,
>
> (2) the taxpayer will permit the regulatory authority to participate in any Associate office conference concerning the request.[27]

Members of the Staff reviewed and suggested edits to the document. They further submitted comments, which included arguments and views of the Staff as to the specific rulings being requested. Staff provided its initial comments in the form of an attachment to the ruling request, as well as feedback to sections drafted by the Company on May 1, 2019. The Company and Staff consultation continued until Staff's final response was received on June 4, 2019. The Staff's final response was a document provided to the IRS as a part of the PLR request.[28] The Company received a notice from the IRS that the aggregated request, to include the Staff comments, had made it to the IRS' file.[29] Staff witness Oligschlaeger also stated that the IRS had noted that Staff filed comments that were attached to MAWC's PLR request.[30]

As a part of the PLR request process, Staff acknowledged the following to MAWC: "Missouri Public Service Commission Staff considers the PLR request to be adequate and complete under the condition that the Staff's Comments are included within the document in full.

[27] Ex. 102P, Wilde Dir., p. 9-10.
[28] Ex. 102P, Wilde Dir., p. 10; Sch. JWR-1, Att. J.
[29] Tr. 52, Wilde.
[30] Ex. 301, Oligschlaeger Reb., p. 7.

Further, under the same condition, Staff does not object to filing of the PLR request with the Internal Revenue Service at this time."[31]

IRS RULING

The IRS provided the requested PLR as of December 3, 2019.[32] The IRS determined that the Commission's actions in reflecting a full deduction of applicable accelerated depreciation amounts without offset for an NOL amount in computing the ISRS surcharge *did* constitute a violation of the Internal Revenue Code's normalization restrictions. However, the IRS also ruled that the Commission's treatment of reflecting a full deduction of applicable repair allowance amounts did not violate the normalization restrictions within the Code.[33]

Staff witness Oligschlaeger summarized that "its recent PLR the IRS has agreed with MAWC's position that it incurred a tax loss during the ISRS periods in prior cases due to the addition of ISRS plant, and that this loss must be reflected in ISRS rates due to the Internal Revenue Code's normalization requirements."[34] He further states that "within the PLR, it is clear to Staff that the IRS expressed agreement with MAWC's contentions that an NOL was generated during the ISRS periods at issue due to ISRS plant additions, and that the NOL amount applicable to ISRS plant additions should be determined using the so-called 'with-and-without' method."[35]

The request for PLR Ruling 9 stated as follows:

**_____
_____
_____

[31] Ex. 103P, Wilde Reb., p. 6.
[32] Ex. 102C, Wilde Dir., Sch. JRW-2.
[33] Ex. 102C, Wilde Dir., p. 11 (language was included in the publicly available PLR).
[34] Ex. 301, Oligschlaeger Reb., p. 3; See Ex. 301, Oligschlaeger Dir., p. 8 (". . . the PLR, and in particular the language wherein the IRS grants MAWC's requested ruling no. 9 is interpreted by Staff as effectively affirming MAWC's prior position taken in ISRS cases. . . .").
[35] Ex. 301, Oligschlaeger Reb., pp. 4-5.

_____
_____
_____
_____
_____
_____
_____
_____
_____.**[36]

The IRS ruled as follows as to Ruling 9:

> 9) Under the circumstances described, in order to comply with the normalization method of accounting within the meaning of § 168(i)(9), the amount of depreciation related ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case must be decreased to reflect a portion of the NOL for the test period for the Surcharge Case which would not have arisen had Taxpayer not reported depreciation-related book/tax differences during the text period for the Surcharge Case and such decrease in depreciation-related ADIT must be an amount that is no less than the amount computed using the With-and-Without Method.[37]

The IRS made it clear in Ruling 9 of the PLR that if the Company has a NOLC balance at any point during the period in which the rate base component of the ISRS is computed, and the Company's investment and operation of ISRS property during the relevant period rates are set (the ISRS test year) is generating a taxable loss, and the loss is generated by accelerated depreciation deductions, then it would be inconsistent with, and a violation of, the tax normalization rules not to include the portion of the Company's NOLC balance deferred tax asset balance in the ISRS rate base that relates to ISRS property for which the Company claimed accelerated tax depreciation as measured using the with and without test.[38]

[36] Ex. 101C, Wilde Dir., Sch. JRW-2, pp. 10-11 of 23.
[37] Ex. 101C, Wilde Dir., Sch. JRW-2, p. 21 of 23 (language was included in the publicly available PLR).
[38] Ex. 102C, Wilde Dir., p. 11 (the subject was included in the publicly available PLR). While there is reference in this case to Ruling 8 as an alternative to Ruling 9, if the proposed adjustment is made pursuant to Ruling 9, there is no need for the Commission to address Ruling 8. (Tr. 68-69. Wilde; Ex. 103P, Wilde Reb., p. 12-13).

OPC seems to suggest that MAWC framed the facts and questions in the PLR request to achieve a desired outcome, and the IRS somehow "rubber-stamped" the request, in spite of its review of the Commission's decision in File No. WO-2018-0373 and Staff's comments. Ruling 5 shows that this was not the case. MAWC sought a ruling from the IRS with respect the treatment of tax repairs that if granted would result in far less significant impact on the ISRS than MAWC sought in the relevant ISRS proceeding. MAWC's reasoning was the ruling it sought in the PLR request represented what MAWC believed to be the most likely outcome based on known facts and circumstances applied to relevant law and regulation, and not a desired outcome reflective of what MAWC believes to be the actual economic implications to MAWC. The revenue requirement difference in the ISRS Case WO-2018-0373 alone was $0.9 million for both the NOL MAWC sought to have added in that case related to tax repair deduction as well as accelerated depreciation deductions. However, the IRS, consistent with the ruling that MAWC requested and the IRS ultimately issued, found that the Commission's treatment of the NOL related to the repairs deduction did not create a normalization violation. In addition, IRS Ruling 3 was the exact opposite outcome to the ruling MAWC sought in its PLR request.[39]

OPC witness Riley suggests that perhaps the Commission should direct that MAWC seek further guidance from the IRS before action on this matter is taken.[40] Mr. Riley makes this suggestion without citing an IRS procedure or other authority pursuant to which additional guidance could be sought. The Company is not aware of any such opportunity to seek additional guidance before the IRS would be required to act on the violation that has already occurred.

Moreover, the IRS has consistently held in prior rulings and guidance that upon recognizing its failure to comply with the normalization rules, the taxpayer needs to change the

[39] Ex. 103C, Wilde Reb., pp. 10-11; Tr. 67-68, Wilde (the subject was included in the publicly available PLR).
[40] Tr. 88-89, Riley.

inconsistent practice or procedure to a consistent practice or procedure *at the next available opportunity* in a manner that totally reverses the effect of the inconsistent practice or procedure, provided the taxpayer's regulator adopts or approves the change.[41] This matter has already continued for eighteen months past the point where the IRS has identified the first violation (December of 2018). It would be unreasonable to add further delay and wait for additional information for which there is no known avenue to obtain.

BENEFITS OF ADJUSTMENT

Making the adjustment as proposed by the Company and Staff has several benefits.

First, addressing the matter in this manner provides more certainty in terms of truly curing the issue with respect to the IRS.[42] The IRS has consistently held in prior rulings and guidance that upon recognizing its failure to comply with the normalization rules, the taxpayer needs to change the inconsistent practice or procedure to a consistent practice or procedure *at the next available opportunity* in a manner that totally reverses the effect of the inconsistent practice or procedure, provided the taxpayer's regulator adopts or approves the change.[43] Making the adjustment here would address the *next available opportunity* requirement.

Second, addressing the issue within the current ISRS ensures that the Company collects no more and no less than the identified amount and allows recovery to be received from only those customers to which the ISRS applies.[44]

[41] Ex. 102P, Wilde Dir., p. 6; *see, e.g.,* Safe Harbor for Inadvertent Normalization Violations, I.R.S. Rev. Proc. 2017-47, Section 3.01(3), 2017 WL 4099476 (Sept. 18, 2017).
[42] Ex. 101, LaGrand Dir., p. 6.
[43] Ex. 102P, Wilde Dir., p. 6; *see, e.g.,* Safe Harbor for Inadvertent Normalization Violations, I.R.S. Rev. Proc. 2017-47, Section 3.01(3), 2017 WL 4099476 (Sept. 18, 2017).
[44] Ex. 101, LaGrand Dir., p. 6.

CONSEQUENCE OF VIOLATION

Because of the PLR's finding that the Company violated the tax normalization rules in regard to applicable accelerated depreciation amounts, a failure to cure the normalization violation in some fashion could cause MAWC to lose significant tax benefits currently benefiting customers. Specifically, MAWC could lose its ability to claim accelerated tax depreciation deductions. Accelerated tax depreciation allows the Company to expense investments faster for tax purposes than for book purposes. This differential, sometimes described as a "zero interest loan" from the government, is a reduction to rate base. All else being equal, both the Company's revenue requirement and the customer's rates are lower when the Company can utilize this tax treatment.[45]

OPC invites the Commission to ignore the IRS PLR and reach its own conclusions as to the tax normalization issue. This would be an extraordinary approach given that, ultimately, tax normalization and the consequence of violations are "tax" questions for the IRS. As Staff witness Oligschlaeger states, "the IRS is the agency designated to interpret its Code and to determine whether the actions of taxpayers (and, for regulated utilities, the actions of its regulators) are in compliance with the IRS Code."[46] He further states that ". . . while the IRS certainly has no direct power to set utility rates, the consequences of violating the IRS Code in respect to the normalization requirements are of ***sufficient gravity*** to command the attention of all parties to Commission proceedings, and the Commission itself in regard to tax normalization issues in rate proceedings."[47]

[45] Ex. 102P, Wilde Dir., pp. 7-8.
[46] Ex 301, Oligschlaeger Reb., p. 3.
[47] *Id*.

Staff witness Oligschlaeger further stated as follows in regard to whether an "ounce of prevention" would be appropriate in this case:

> I agree that in this particular case in these particular circumstances the Commission should take an attitude of an ounce of prevention preventing something worse happening overall. By something worse, I mean the potential loss of the accelerated depreciation deduction.
>
> The reality is that what the IRS said in this PLR only applies or only must be taken into account for much less than 1 percent of the dollar values that were actually at issue in the case.· I think in each case there was somewhere between 800, 900,000, maybe up to a million dollars at issue. When all is said and done, because of how the IRS ruled on the PLR, only somewhere between 5 to $10,000 per case ultimately was at issue and needs to be charged to the customers.
>
> Given, you know, given the hypothetical choice of do we fight what the IRS is doing somehow or do we accept it, given the very small volume of dollars, I don't think that would be a hill I would recommend that we climb.[48]

It makes no sense to play a game of "chicken" with the IRS over this $35,328 impact, as encouraged by the OPC, given the significant adverse impact for the Company and the customers if there is a tax normalization violation and loss of accelerated depreciation.

OPC ARGUMENTS

NOL

OPC witness Riley continues to argue, without citation to any specific IRS rules or rulings, that a net operating loss (NOL) is a "tax return item" and cannot be computed in interim period for purposes of ISRS rates. This is directly contrary to the PLR, in which the IRS acknowledges that it is addressing a loss in an interim period and not as of the date a tax return is filed.[49] The IRS, under these circumstances, still indicates that it is appropriate to address a taxable loss, and provides sufficient guidance for both Staff and the Company to recommend an adjustment to address the NOL.

[48] Tr. 112-113, Oligschlaeger.
[49] Ex. 102C, Wilde Dir., Sch. JRW-2, pp. 6 (Schedule), 20 (Ruling 2) of 23.

It is an unavoidable conclusion that the IRS has a different view of NOL in this circumstance than does Mr. Riley. As stated above, Mr. Oligschlaeger accurately observed that ". . . the IRS appears to have a different working definition of NOL in the context of ISRS rate cases than Staff or OPC in the past."[50]

OPC cites to 2018 tax return information as purported support for its position, without regard to how the IRS included that information in its analysis of the tax normalization rules. OPC points to line 28 of the tax return[51] provided to allege that American Water had taxable income in 2018. Line 28 is, however, clearly labeled as "Taxable income before net operating loss deduction and special deductions." Thus, line 28 does not demonstrate whether American Water or MAWC had taxable income sufficient to use all tax deductions available and avoid a deferral of tax deductions.

Line 29 of the same return and Form 1120 of that same return[52] demonstrate that American Water and MAWC had insufficient taxable income to use all of the tax deductions available to them during 2018. Thus, taxable income for 2018 after use of deductions reconciles to **_____ _____** Form 1120 of that return clearly shows **_____ _____ _____.**

The situation represented by the 2018 tax return[54] is consistent with the situation as represented in the request for PLR submitted by MAWC (which at that time was an estimation of

[50] Tr. 118, Oligschlaeger.
[51] Exh. 200, p. 2 of 531.
[52] Exh. 200, p. 330 of 531.
[53] Exh. 200, p. 330 of 531.
[54] Exh. 200.

2018).[55] That is, there is taxable income prior to use of deductions, to include NOLC However, there is not sufficient income to use all deductions.

The Staff acknowledges that the PLR seemed to accept that an NOL existed in the prior case. However, Staff witness Oligschlaeger also observed that he did not think that made any practical difference:

> While the PLR does not necessarily provide any evidentiary support or extensive explanation for the basis for the IRS' conclusions and rulings, it is quite clear that the IRS views an NOL to be applicable to MAWC's past ISRS cases, and that the NOL must be recognized in some fashion in order to comply with the IRS Code's normalization requirements.[56]

The IRS identified a tax loss or NOL that was the result of ISRS surcharge revenue received by MAWC less tax deductions available to MAWC as of the rate base determination date for ISRS property. The IRS identified the "with and without" method as the appropriate means of determining the amount of that loss that should be considered as deferred either by incorporating a NOL deferred tax asset or reducing the Accelerated Depreciation deferred tax liability in the ADIT balance included in ISRS rate base.[57]

The schedules provided by MAWC witness LaGrand and OPC witness Riley demonstrate that the tax deductions available to MAWC related to ISRS property far exceed the taxable income from ISRS as of each of the four dates that ISRS rate base was measured. Further, those schedules indicate that the accelerated tax depreciation deductions were less than the total loss, which in applying the "with and without" test would indicate there was a loss or deferral of accelerated depreciation deductions equal to the accelerated depreciations deductions claim

[55] *See* Ex. 102C, Wilde Dir., Sch. JRW-1, pp. 18-19 of 134; and General Response to OPC Allegations above.
[56] Ex. 301, Oligschlaeger Reb., p. 7.
[57] Ex. 102C, Wilde Dir., Sch. JRW-2, pp. 21 of 23 (Ruling 9).

through that date. Therefore, MAWC and Staff have proposed an adjustment that needs to be made pursuant to the tax normalization rules.

CIAC

OPC witness Riley alleges in his Rebuttal Testimony that MAWC failed to consider contributions in aid of construction ("CIAC") in its NOL calculation.[58] As the name suggests, these are amounts provided by third parties related to plant improvements. Pursuant to the Tax Cuts and Jobs Act, CIAC became fully taxable as income to utilities. As of December 7, 2018, MAWC's tariff was changed to state as follows:

> Any Federal, State or Local income tax incurred by the Company due to the receipt of taxable Advances or Contributions in Aid of Construction, as defined by the Internal Revenue Service, the State of Missouri, or other taxing authority, and not otherwise paid by a third party, will be paid by the Company. Such income taxes shall be segregated in a deferred account for inclusion in rate base in the Company's next general rate proceeding.[59]

Prior to this tariff change, the contributing party was responsible for any taxes associated with the contributed amount.

MAWC's calculations in cases WO-2019-0184 and WO-2019-0389, as well as this case, take into account CIAC in its deferred tax and NOL calculations.[60] CIAC is also taken into account as an offset to rate base. These adjustments may be seen at the following locations in the workpapers containing MAWC's calculation of "Deferred Taxes," to include the "Net Operating Loss" attached to MAWC witness LaGrand's Direct Testimony:

- Ex. 203, Riley Amnd. To Reb., Sched. JSR-AR-1, p. 4 of 8 (see line 30, "Taxable Income – Contributions")

- Ex. 203, Riley Amnd. To Reb., Sched. JSR-AR-1, p. 6 of 8 (see line 30, "Taxable Income – Contributions")

[58] Ex. 202, Riley Reb., pp. 3-4, 5-6.
[59] Notice That Tariff Will Be Allowed to Go Into Effect, Case No. WT-2019-0054 (December 5, 2018).
[60] Tr. 65, 68, Wilde.

- Ex. 203, Riley Amnd. To Reb., Sched. JSR-AR-1, p. 8 of 8 (see line 30, "Taxable Income – Contributions")

- Ex. 101, LaGrand Dir., Sch. BWL-3, pp. 5 and 7 of 7 (see line 30, "Taxable Income – Contributions")

- Ex. 101, LaGrand Dir., Sch. BWL-2, p. 2 of 7 (see line 30, "Taxable Income – Contributions")

As this issue arose for the first time during rebuttal testimony, MAWC was unable to address it in responsive testimony. However, the workpapers provided in this case show that CIAC was not ignored by the Company and, in fact, was specifically considered in NOL calculations.

INABILITY TO ASSIGN NOL TO SPECIFIC PLANT

Through cross-examination, OPC raised the question as to whether NOLs are specifically tracked as to origin.[61] Staff witness Oligschlaeger suggested that "NOLs are calculated on an overall basis and are not split out for accounting purposes by the various tax deductions that may contribute to an NOL situation."[62] However, Mr. Oligschlaeger also explained that MAWC asked the IRS to rule as to whether the "with and without" method should be used to determine the amount of NOL that should be used in the ISRS rate process and that the ISRS, in the PLR, had agreed with MAWC.[63] Accordingly, this is a subject that has no import as to the normalization violation found by the IRS.

[61] Tr. 109, Oligschlaeger.
[62] *Id*..
[63] *Id*. at p. 110-111.

OTHER REVENUES

ISRS revenues are taken into account in MAWC's NOL calculation.[64] However, OPC witness Riley alleges in his Rebuttal Testimony that MAWC did not address in the NOL "the existence of ongoing revenue related to the pipes in question arising from the sale of water flowing through those pipes." (Ex. 202, Riley Reb., pp. 3-4). By "ongoing revenue," Mr. Riley means revenues associated with MAWC's base rates that were established in File No. WR-2017-0285. (Tr. 82, Riley).

Mr. Riley's allegation has no significance in regard to the PLR's finding. As discussed above, the PLR, as well as the Company's request for the PLR, recognize the existence of other revenues. **_____

_____

_____
_____.**[65]

The resulting PLR recognized as follows:

> For year 2, Parent (on a consolidated basis) and Taxpayer (on a separate company basis) estimate that taxable income was earned and, thus, NOLC was utilized.[66]

Thus, the IRS clearly knew that there were revenues other than those from the ISRS and that those revenues produced net operating income in the year under consideration before taking into account the NOLC.

Moreover, the rates in File No. WR-2017-0285 were based on a true-up period ending December 31, 2017.[67] The base rates only contemplate plant in service as of December 31,

[64] Tr. 70-71, Wilde.
[65] Ex. 102C, Wilde Dir., Sch. JRW-1, pp. 18-19 of 134). Moreover, the request for PLR also provided a table showing Net Operating (Income) for 2018. Ex. 102C, Wilde Dir., Sch. JRW-1, p. 19 of 134.
[66] Ex. 102C, Wilde Dir., Sch. JRW-2, p. 7 of 23.

2017.[68] MAWC's ISRS only applies to ISRS eligible plant in St. Louis County. Mr. Riley has no idea how much non-ISRS eligible plant MAWC has placed in service in St. Louis County since December 31, 2017.[69] He also has no idea how much plant MAWC placed in service outside St. Louis County since December 31, 2017.[70]

MAWC's base rates, as established in File No. WR-2017-0285, were designed to address the costs to provide water service as of December 31, 2017. One of the requirements of ISRS eligible plant is that it "not increase revenues by directly connecting the infrastructure replacement to new customers."[71] There is no basis to somehow assign the base rate revenues to the new plant investment that has taken place since 2017.

OPC "END OF THE WORLD" SCENARIO

At the hearing of this matter, OPC witness Riley argued for the first time in this case that a ruling in favor of MAWC's and Staff's position would be a cataclysmic event for the entire regulated utility world and its customers as it would cause MAWC and other utilities to seek rate base adjustments outside of a full rate case or ISRS proceeding. (Tr. 98-100, Riley). Mr. Riley projects such dire consequences from a ruling in favor of MAWC that "it would probably require federal, some sort of federal law changes."[72]

First, MAWC has made no such claim of far ranging impact, either in this case or in the request for the PLR.

---

[67] *In the Matter of Missouri-American Water Company*, Report and Order, p. 5, File No. WR-2017-0285 (May 2, 2018).
[68] Tr. 83, Riley.
[69] *Id*..
[70] *Id*. at pp. 83-84.
[71] Section 393.1000(3)(c).
[72] Tr. 99, Riley.

Second, the IRS addressed the need to address a changing NOLC balance related to property placed in service outside of test year used to set base rates. Ruling 11 precludes that from being a concern. Ruling 11 states:

> 11) Under the circumstances described above, in order to comply with the normalization method of accounting within the meaning of § 168(i)(9), it is not necessary to decrease ADIT or otherwise increase rate base for the Surcharge Case by the portion of the NOLC which would not have arisen (or an increase in such NOLC which would not have arisen) had Taxpayer not reported depreciation-related book/tax differences in prior periods or during the test period for the Surcharge Case with respect to public utility property with rates not set by the Surcharge Case.[73]

In other words, it is the existence of the ISRS case and the reflection in ISRS rates of the depreciation-related book/tax differences that triggers this situation.

Staff witness Oligschlaeger also addressed this issue in his testimony as follows:

> First of all, is this going to be a precedent for other utilities.· It is stated within the PLR, it is stated within all PLRs that they are not taken as precedent for anyone else other than the taxpayer and the specific circumstances that they discuss in a PLR request.· Staff interprets that as meaning that the PLR to the extent the Commission needs to take that into account only applies to Missouri-American, only applies to Missouri-American as long as it has an NOL on its books, and only applies to ISRS rate proceedings, not to general rate cases.
>
> So for that reason -- So no other utilities, or at least Staff views it as this really doesn't establish precedent for any other utility or for any other venue other than ISRS cases.· So I think the impact is quite limited and just because another company in another type of case may raise the same arguments, I don't think they can use the PLR as direct support for that and we would look at it in the same way as we did in the past for Missouri-American.[74]

An order in favor of the $35,328 adjustment proposed by MAWC and Staff will serve to cure the tax normalization matter identified in the PLR. It will not be the end of utility regulation as we know it. OPC witness Riley's fear of far ranging impacts is unfounded.

[73] Ex. 101C, Wilde Dir., Sch. JRW-2, p. 21 of 23 (language was contained in the public version of the PLR.
[74] Tr. 111-112, Oligschlaeger.

ISSUE 2

2. **Should MAWC's incremental pre-tax revenue requirement in this matter include recognition of deferred taxes associated with accelerated depreciation tax timing differences?**

Section 393.1000(1)(a) indicates that "appropriate pretax revenues" associated with an ISRS include "accumulated deferred income taxes and accumulated depreciation associated with eligible infrastructure replacements which are included in a currently effective ISRS." MAWC's ISRS recognizes accumulated deferred income taxes, along with the above-referenced NOL deferred tax asset, associated with the eligible infrastructure system replacements included in MAWC's current ISRS. MAWC is not aware of any controversy related to this issue.

CONCLUSION

The Commission should conclude that MAWC shall be permitted to establish an ISRS to recover ISRS revenues for this case in the amount of $9,725,687, which includes the $35,328 associated with MAWC's proposal to address the normalization violations discussed herein. Those revenues will differ from those contained in the tariffs MAWC first submitted, as they included pro forma amounts for February and March that were later replaced with additions actually placed into service in February through March. Therefore, the Commission should reject the originally submitted tariffs and allow MAWC an opportunity to submit new tariffs based on the rate design testified to by Staff witness Barnes (to which there was no objection).[75]

WHEREFORE, MAWC respectfully requests the Commission consider this *Brief* and

[75] Ex. 304, Barnes Dir., p. 2.

issue such orders as it should find to be reasonable and just.

Respectfully submitted,

Dean L. Cooper MBE #36592
BRYDON, SWEARENGEN & ENGLAND P.C.
312 E. Capitol Avenue
P. O. Box 456
Jefferson City, MO 65102
(573) 635-7166
dcooper@brydonlaw.com

Timothy W. Luft, MBE #40506
Corporate Counsel
MISSOURI-AMERICAN WATER COMPANY
727 Craig Road
St. Louis, MO 63141
(314) 996-2279 telephone
(314) 997-2451 facsimile
timothy.luft@amwater.com

ATTORNEYS FOR MISSOURI-AMERICAN WATER COMPANY

CERTIFICATE OF SERVICE

I hereby certify that a copy of the above and foregoing document was sent via electronic mail on this 8th day of June, 2020, to:

Mark Johnson
Staff Counsel's Office
mark.johnson@psc.mo.gov

John Clizer
Office of the Public Counsel
john.clizer@opc.mo.gov