

Exhibit No.:  
Issue:Regulatory Plan Amortization and Gross-up for Taxes  
Witness: Bryan Weiss  
Type of Exhibit: Surrebuttal Testimony  
Sponsoring Party: Kansas City Power & Light Company  
Case No.: ER-2006-0315  
Date Testimony Prepared: August 18, 2006

**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO.: ER-2006-0315**

**SURREBUTTAL TESTIMONY**

**OF**

**BRYAN WEISS**

**ON BEHALF OF**

**KANSAS CITY POWER & LIGHT COMPANY**

**Kansas City, Missouri  
August 18, 2006**

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In the Matter of the Empire District Electric  
Company of Joplin, Missouri for Authority  
To File Tariffs Increasing Rates for Electric  
Service Provided to Customers in the  
Missouri Service Area of the Company.

)  
)  
) Case No. ER-2006-0315  
)  
)

**AFFIDAVIT OF BRYAN WEISS**

**STATE OF MISSOURI** )

) ss

**COUNTY OF JACKSON** )

Bryan Weiss, being first duly sworn on his oath, states:

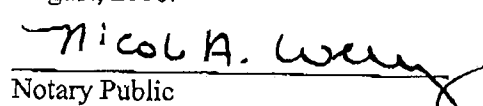
1. My name is Bryan Weiss. I work in Kansas City, Missouri, and I am employed by Kansas City Power & Light Company as an Income Tax Analyst.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of Kansas City Power & Light Company consisting of (7) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.

  
Bryan Weiss

Subscribed and sworn before me this 18<sup>th</sup> day of August, 2006.

  
Notary Public

My commission expires: Feb. 4, 2007

<p style="text-align: center;"><b>NICOLE A. WEHRY</b> Notary Public - Notary Seal STATE OF MISSOURI Jackson County My Commission Expires: Feb. 4, 2007</p>
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1    **Q:    Have you previously testified in a proceeding at the Missouri Public Service**  
2           **Commission or before any other utility regulatory agency?**

3    A:    No, I have not.

4    **Q:    What is the purpose of your testimony?**

5    A:    The purpose of my testimony is to address the Rebuttal Testimony of Ted  
6           Robertson on the issue of whether the amortization under Empire's Regulatory  
7           Plan should be grossed-up for income taxes. Beginning on page 19 of his rebuttal  
8           testimony, he discusses the amortization calculation that results from the Empire  
9           Regulatory Plan. In particular, on page 30 of his rebuttal testimony, Mr.  
10          Robertson states: "Lastly, it is the Public Counsel's belief that once the  
11          amortization is determined, the amount should not be grossed-up for income  
12          taxes." (Rebuttal Testimony of Ted Robertson, p. 30) Mr. Robertson's position  
13          on this issue is supportive of the position taken by Staff on this issue in the  
14          Supplemental Direct Testimony of Mark L. Oligschlaeger on pages 11-12.

15   **Q:    Do you agree with the positions expressed by Mr. Robertson and Mr.**  
16           **Oligschlaeger?**

17   A:    No, I do not.

18   **Q:    Please explain the reason that KCPL is taking a position on the**  
19           **appropriateness of grossing-up the amortization in this case.**

20   A:    KCPL is very concerned about this issue in this case because the amortization  
21          provided for in Empire's Regulatory Plan is very similar to the amortization  
22          approach approved by the Commission for Kansas City Power & Light Company  
23          in its Regulatory Plan approved in Case No. EO-2005-0329. It is essential to both

1 KCPL and Empire that the Commission consider the implications of the tax  
2 effects of the amortizations appropriately. Otherwise, the benefits of the  
3 amortizations in maintaining the investment grade ratings for these public utilities  
4 will not be realized.

5 **Q: Are you familiar with the position the Public Counsel and Staff have taken**  
6 **with regard to whether or not these amortizations should be grossed-up for**  
7 **income taxes?**

8 A: Yes, as I mentioned already in this testimony, both Public Counsel and Staff have  
9 proposed that no gross-up for income taxes should be allowed on the  
10 amortizations.

11 **Q: Do you agree with this proposal?**

12 A: No, I do not.

13 **Q: Please explain what the term “gross-up for income taxes” means in this**  
14 **context.**

15 A: In the ratemaking process, it is necessary to recognize the additional income taxes  
16 that result from the additional revenues being allowed in the cost of service. The  
17 “gross-up for income taxes” is a short-hand description of the method of  
18 increasing a revenue stream to include the additional income tax expenses in the  
19 cost of service. For example, when the Commission grants a rate increase, it is  
20 necessary to “gross-up” the rate increase to include the expected tax effects of the  
21 rate increase. Otherwise, the public utility does not receive the additional  
22 revenues necessary to achieve its revenue requirement. As I explain below, the  
23 amortization approved for Empire and KCPL in their respective Regulatory Plans

1 will create additional revenues that need to also be "grossed-up" to recognize the  
2 tax effects of the amortization.

3 **Q: How is the amortization approved under the Regulatory Plan of Empire**  
4 **treated for book and tax purposes?**

5 A: For Book purposes, the amortizations are included in gross revenues with an  
6 offsetting accelerated depreciation expense. This results in no change to Empire's  
7 net operating income. For Tax purposes, the amortizations are includable in gross  
8 taxable income under Internal Revenue Code (IRC) Section 61. However, under  
9 the MACRS depreciation rules of IRC Section 168, there will be no offsetting  
10 depreciation deduction. This results in an increase in current taxes payable equal  
11 to Empire's current effective tax rate times the total amortizations allowed. The  
12 ultimate result is that Empire pays cash to federal and state taxing authorities that  
13 is intended to be used to maintain the financial ratios that were agreed upon in its  
14 regulatory plan.

15 **Q: Would you provide an example using numbers to illustrate the need to gross-**  
16 **up these amortizations for income taxes?**

17 A: Assume that Empire requires an additional \$1,000 to maintain its financial ratios.

18 The calculations under the Staff's proposal of no gross-up are:

19		
20	Book Revenue	\$ 1,000
21	Book Depreciation	<u>\$(1,000)</u>
22	Net Income	\$ 0
23		
24	Tax Income	\$ 1,000
25	Tax Depreciation	<u>\$ 0</u>
26	Taxable Income	\$ 1,000
27	Effective Tax Rate	<u>38.39%</u>
28	Taxes Payable	\$ 384

The net cash received in the example is \$616 (\$1,000 Revenue - \$384 Income Taxes). Thus, Empire is short \$384 of maintaining its agreed-upon ratios.

Consider the additional \$1,000 of cash required with gross-up for income taxes included:

Book Revenue	\$ 1,623
Book Depreciation	<u>\$(1,623)</u>
Net Income	\$ 0
Tax Income	\$ 1,623
Tax Depreciation	<u>\$ 0</u>
Taxable Income	\$ 1,623
Effective Tax Rate	<u>38.39%</u>
Taxes Payable	\$ 623

The net cash received is \$1,000 (\$1,623 Revenue - \$623 Income Taxes) and Empire has received the appropriate net amount of cash to maintain its agreed-upon ratios.

**Q: Do you believe that this illustration shows that the amortization amount included in rates will be considered taxable by federal and state taxing authorities?**

**A:** Yes.

**Q: On page 26 of his rebuttal testimony, Mr. Robertson also quotes the Supplemental Direct Testimony of Mark L. Oligschlager where he indicates that the income tax effects in the amortization amounts granted in rates should not be recognized in rates "unless the utility can demonstrate that it will not derive sufficient benefits in deferred taxes from its ongoing plant in**

1        **service additions to offset any additional tax liability associated with the**  
2        **regulatory plan amortizations.” Do you agree with this position?**

3    A:    No. It is not clear whether the benefits of deferred taxes from a public utility’s  
4        ongoing investment in new plant will completely offset any additional tax liability  
5        associated with the regulatory plan amortizations. This will depend upon many  
6        speculative factors which can not be reasonably calculated at this time. What is  
7        clear is that if the Commission does not gross-up the amortization for income  
8        taxes, it is likely that Empire will not be able to achieve the financial metrics  
9        necessary to maintain an investment grade rating from the rating agencies. In  
10       particular, the Funds From Operations (“FFO”) metric will be extremely difficult  
11       to achieve. If the FFO metric is not achieved, as described in the Regulatory  
12       Plans, then the investment grade rating could be in jeopardy. Of course, this goal  
13       of maintaining an investment grade rating was the reason that the parties in the  
14       Regulatory Plan proceedings recommended including the amortization in the  
15       Regulatory Plans of Empire.

16   **Q:    Are you aware of other regulatory staff in other jurisdictions which have**  
17   **addressed this issue?**

18   A:    Yes. In KCPL’s pending Kansas rate case, the KCC Staff has filed testimony  
19        which indicates that the amortization (referred to in Kansas as the “CIAC”) “must  
20        be grossed up for taxes in order for KCPL to receive the amount of additional  
21        revenues (net of tax) necessary for it to meet its credit metrics.” (Direct  
22        Testimony of Jeffrey D. McClanahan, p. 13, KCC Docket No. 06-KCPE-828-  
23        RTS.)



1   **Q:**    Please summarize your position on gross-up for income taxes on these  
2           amortizations.

3   **A:**    In order to receive the proper amount of cash to maintain the financial ratios  
4           agreed to in its regulatory plan, Empire is entitled to a gross-up for income taxes  
5           on any amortizations allowed.

6   **Q:**    Does this conclude your testimony?

7   **A:**    Yes, it does.