Exhibit No.: _____
Issue: Excess Accumulated Deferred Income Tax
Witness: Michael McCuen
Type of Exhibit: Direct Testimony
Sponsoring Party: Liberty Utilities (Missouri Water) LLC d/b/a Liberty
Case Nos.: WR-2024-0104 and SR-2024-0105
Date Testimony Prepared: March 2024

Before the Public Service Commission
of the State of Missouri

Direct Testimony

of

Michael McCuen

on behalf of

Liberty Utilities (Missouri Water) LLC d/b/a Liberty

March 13, 2024

Liberty™

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FOR THE DIRECT TESTIMONY OF MICHAEL MCCUEN
LIBERTY UTILITIES (MISSOURI WATER) LLC D/B/A LIBERTY
BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION
CASE NOs. WR-2024-0104 and SR-2024-0105

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Michael McCuen. My business address is 602 South Joplin Avenue, Joplin, Missouri, 64802.

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

A. I am employed by Liberty Utilities Service Corp. ("LUSC"), as Director of U.S. Tax Planning and Strategy.

Q. On whose behalf are you testifying in this proceeding?

A. I am testifying on behalf of Liberty Utilities (Missouri Water) LLC d/b/a Liberty ("Liberty" or the "Company").

Q. Please describe your educational and professional background.

A. I received a Bachelor of Business Administration degree in Accounting from Franklin University in 1992. I received a Juris Doctor degree from Capital University Law School in 2000. I am a Certified Public Accountant in the State of Ohio and licensed to practice law in the State of Ohio. I held various accounting and tax positions through 2007. In 2007, I joined Mettler-Toledo as U.S. Tax Manager with responsibility for all income tax matters for their U.S. subsidiaries. In 2012, I was named Head of U.S. Taxation for Mettler-Toledo with responsibility for all tax matters within the U.S. I joined NiSource Corporate Services Company, a management and services subsidiary of NiSource, in May 2012 as Director of Income Taxes. I have been employed by

Liberty since January 2021. I began as a Senior Tax Manager before transitioning into my current role as Director, U.S. Tax Planning & Strategy.

Q. Have you previously filed testimony before the Missouri Public Service Commission ("Commission")?

A. Yes. I filed testimony before this Commission in Case No. GR-2024-0106, in support of Liberty Utilities (Midstates Natural Gas) Corp.

Q. Have you testified in other regulatory jurisdictions?

A. Yes. I have testified before the Indiana Utility Regulatory Commission, the Public Service Commission of Maryland, the Public Service Commission of Kentucky, the Public Service Commission of Ohio, and the New York State Public Service Commission.

II. PURPOSE

Q. What is the purpose of your direct testimony in this proceeding?

A. I describe the impact of the federal Tax Cuts and Jobs Act of 2017 ("TCJA") and the statutory changes implemented by Missouri Senate Bill 884 (2018) on Liberty's deferred taxes, and I provide the Company's proposal for the treatment of the resulting Excess Accumulated Deferred Income Taxes ("EADIT").

Q. What direct testimony schedules are you sponsoring?

A. I am sponsoring the following:

- **Direct Schedule MM-1** – MO Summary
- **Direct Schedule MM-2** – TCJA Summary

III. EXCESS ACCUMULATED DEFERRED INCOME TAXES ("EADIT")

Q. Please describe the TCJA and its impact on Liberty's ADIT.

A. The TCJA was enacted by the United States Congress on December 20, 2017, and was signed into law by the President on December 22, 2017. *See* Tax Cuts and Jobs Act of 2017, Pub. Law 115-97, 131 Stat. 2054 (2017). The most significant provision of the TCJA for Liberty was the reduction of the Federal Income Tax rate from 35% to 21%. This rate reduction required Liberty to remeasure the amounts of Accumulated Deferred Income Taxes ("ADIT") in the Company's financial statements as of December 31, 2017.

Q. Please provide background on MO S.B. 884 and the impact on Liberty.

A. On June 1, 2018, Missouri enacted legislation (S.B. 884) that brought significant changes to business taxation starting with the 2020 tax year. The law reduced Missouri's tax rate for C corporations from 6.5% to 4%. Similar to the TCJA, this tax rate change required the remeasurement of Liberty's ADIT.

Q. What is the impact of re-measuring Liberty's ADIT?

A. The effect of the re-measurement was the identification of EADIT on the Balance Sheet. These EADIT balances represent the portion of previous deferred taxes which no longer need to be paid to taxing authorities. See calculations in **Direct Schedules MM-1 and MM-2**.

Q. What happens to this EADIT?

A. The EADIT is reclassified from ADIT to a net regulatory liability. This net regulatory liability will be returned to customers through reductions in utility service rates.

Q. How will the regulatory liability related to EADIT be returned to customers?

A. The TCJA requires that normalized EADIT be amortized over "the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes." See TCJA Subtitle C, Part I, Sec. 13001(d)(3)(B). Using Liberty's depreciation study from the Alliance Consulting Group as of December 31, 2022, the weighted average remaining life ranged from 32 to 58 years. The Depreciation Study and supporting detail is included in the direct testimony of Company Witness Dane A. Watson.

Q. Is all EADIT treated the same?

A. No. EADIT can be classified as either "protected" or "un-protected". Protected EADIT relates to plant method/life depreciation of public utility property. Un-protected is generally everything else. The "protected" amount is required to be amortized over the remaining lives of the underlying property and the "unprotected" portion can be amortized over any period of time ordered by the Commission.

Q. What type of EADIT does Liberty have?

A. Liberty has a combination of EADIT on plant-related deferred tax liabilities and deficient ADIT on Liberty's Net Operating Loss ("NOL") deferred tax asset. The combination of these two items results in net EADIT owed to customers. Liberty is treating all EADIT as plant-related. It should be noted that Deficient ADIT is the remeasurement amount of a deferred tax asset, thereby creating an amount owed by customers.

Q. What is a NOL, and why should the NOL ADIT be included in rate base?

A. An NOL is created when, in any year, Liberty reports more tax deductions than it has taxable income. When an NOL must be carried forward, a portion of the deductions claimed by Liberty in the year that the NOL is created will not offset taxable income and not reduce Liberty's tax liability. No cost-free capital was received for the amount of NOL that did not reduce Liberty's tax liability. Therefore, Liberty should reflect in its rate base computation the remaining NOL ADIT that has not provided a cost-free capital benefit.

Q. Did the TCJA have any impact on NOL requirements?

A. Yes. In 2017, the TCJA changed the NOL requirements by: 1) limiting NOL deductions to 80% of taxable income; 2) disallowing NOL carrybacks; and 3) lifting the 20-year limit on NOL carryovers.

Q. Please describe the impact of Liberty's NOL on EADIT.

A. The deficient deferred tax asset related to the NOL carryforward is netted against the excess plant-related deferred tax liability to compute the amount of taxes deferred as a result of accelerated tax depreciation that will not be payable to the government due to the change in tax law. The tax losses would not have occurred had Liberty not computed tax depreciation using an accelerated method, including "bonus depreciation." The deferred tax asset related to the NOL carryforward should increase rate base so that rate base is reduced for the appropriate amount of net deferred tax liabilities (i.e., realized tax savings). The deferred tax asset for the NOL carryforward is presented as a reduction to plant-related deferred tax liabilities because NOLs that would not have resulted had Liberty only deducted the amount of depreciation expense reflected in ratemaking for tax purposes are subject to the deferred tax normalization requirements of the Internal Revenue Code.

Q. What is significant about compliance with the normalization rules?

A. Compliance with the normalization rules is a condition of a utility remaining eligible to deduct accelerated tax depreciation.

Q. How must the amounts be treated?

A. The two amounts, gross depreciation-related deferred tax liabilities and NOL-related deferred tax assets attributable to accelerated depreciation, must be viewed in tandem to properly measure the amount of deferral of tax that has occurred and the maximum refundable excess deferred tax liability. Only tax benefits of accelerated depreciation that have been realized by a utility may result in refundable EADIT. Accelerated depreciation in recent years has absorbed all of Liberty's taxable income, which then created the NOLs. Accordingly, Liberty has not been able to realize the full benefits of the zero-cost capital that would have been provided by the full depreciation-related deferred tax liability. To properly determine the refundable amount of EADIT and to match the depreciation-related timing differences that gave rise to the NOL the tax effected NOL, which was the result of utilizing accelerated depreciation, should be included as a reduction to EADIT.

Q. Please describe any special methods that must be used to return EADIT to customers.

A. The TCJA requires that EADIT on protected book-tax differences reduce customer rates over the book lives of the related property no more rapidly than under the Average Rate Assumption Method ("ARAM"). If the necessary books and records are not available to compute the reversal under ARAM, an alternative approach, referred to as the Reverse South Georgia Method ("RSGM"), can be used. The RSGM is straightforward: determine the EADIT balance and amortize that balance over the estimated remaining useful lives of the assets that created the EADIT. If a new depreciation study is performed and has a different result, the amortization period would be adjusted on a going forward basis.

Q. What method did Liberty use?

A. The choice of ARAM or RSGM is not optional. ARAM must be used unless the records needed to compute ARAM are not available. Liberty does not have the necessary records to utilize ARAM, and therefore is required to use RSGM. Similarly, Liberty Utilities (Midstates Natural Gas) Corp. filed a Notice Regarding Treatment of Excess Accumulated Deferred Income Tax in File No. GR-2018-0013 on January 4, 2019, which explained that the Company had determined that the RSGM was the most appropriate and reasonable method to utilize for computing and normalizing protected EADIT in compliance with Paragraph 7B of the Stipulation in that docket.

IV. CONCLUSION

Q. Please summarize your direct testimony.

A. My testimony identified EADIT that Liberty proposes to pass back to customers associated with both the TCJA tax rate reduction and the Missouri state tax reduction. I further explained the nature of the EADIT and the proper method and timing of the pass-back to customers. In addition, I explained why a deferred tax asset associated with a NOL is required to be included in rate base and why the deficient ADIT created by the two tax rate reductions are required to be netted with the associated plant EADIT that created them.

Q. Does this conclude your direct testimony at this time?

A. Yes.

VERIFICATION

I, Michael McCuen, under penalty of perjury, on this 13th day of March, 2024, declare that the foregoing is true and correct to the best of my knowledge and belief.

/s/ Michael McCuen