Exhibit No.:
Issue: Kansas City Earnings Tax: ESOP 401(k) Dividend tax benefits; NOL ADIT in Rate Base: Tax Benefits of Asset Disposition; EDIT amortization: Property Taxes
Witness: Melissa K. Hardesty
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Evergy Missouri West
Case Nos.: ER-2024-0189
Date Testimony Prepared: August 6, 2024

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2024-0189

REBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

ON BEHALF OF

EVERGY MISSOURI WEST

Kansas City, Missouri
August 2024

REBUTTAL TESTIMONY

OF

MELISSA K. HARDESTY

Case No. ER-2024-0189

Q: Please state your name and business address.

A: My name is Melissa K. Hardesty. My business address is 1200 Main, Kansas City, Missouri 64105.

Q: Are you the same Melissa K. Hardesty who submitted direct testimony on February 2, 2024?

A: Yes.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of Evergy Missouri West, Inc. d/b/a Evergy Missouri West ("EMW").

Q: What is the purpose of your rebuttal testimony?

A: The purpose of my rebuttal testimony is to respond to the direct testimony of: (1) John S. Riley, on behalf of the Office of the Public Counsel ("OPC"), regarding the inclusion of the tax benefits of asset dispositions in the calculation of income tax expense in cost of service and amount of net operating losses ("NOL") accumulated deferred income taxes ("ADIT") included in rate base; (2) Matthew R. Young, on behalf of Missouri Public Service Commission ("MPSC" or the "Commission") Staff, regarding the deduction of allocated ESOP 401(k) dividends when computing the income tax expense in cost of service the exclusion of Kansas City earning tax expense and the method used to compute the annualized amortization of excess deferred income tax ("EDIT") benefits; and (3)

Karen Lyons, on behalf of MPSC Staff, regarding the method of computing property tax expense in the MPSC Staff direct filing.

TAX LOSSES ON ASSET DISPOSITIONS

Q: Do you agree with Mr. Riley that the tax benefits of asset dispositions should be included in the calculation of income tax expense in cost of service?

A: The reduction of income by the tax losses on asset dispositions proposed by Mr. Riley ignores the simplified method used by the Company and Staff to compute income tax expense in cost of service. If the tax losses were included as a reduction in current income tax expense without an offset for the impact on deferred income taxes, then the losses would be double counted in computing income tax expense over time.

Q: Please explain the simplified method used by the Company and Staff to compute income tax expense?

A: The simplified methodology used the Company and Staff eliminates the need to specifically identify all book and tax differences in computing income tax expense. Most significantly, all basis differences between the book basis and tax basis of assets are ignored in the current tax provision. This includes the write-off of any remaining tax basis due to the retirement of an asset. Only the difference between book depreciation and tax depreciation is included in computing current income tax expense. The difference in the timing of depreciation deductions for book and tax purposes is a temporary difference. Therefore, an offsetting deferred tax expense adjustment is applied to ensure that a level of total income taxes included in cost of service was as if depreciation deductions used to arrive at taxable income were based solely on depreciation of tax basis on a straight-line basis.

The write-off of any tax basis for tax purposes is also just a temporary or timing difference. Any remaining book basis for which a loss was not recognized upon the retirement will eventually be recovered through an adjustment to future book depreciation rates and book depreciation deductions. Under mass asset accounting, the book depreciation deduction will eventually recover the full basis of any asset disposed of, just like we have deducted the full tax basis of the asset through tax depreciation, tax basis adjustments, or the tax loss on disposal.

If the Company included the tax loss in the computation of current tax expense, an offsetting deferred tax expense would also need to be recorded. The resulting income tax expense, considering both the current and deferred income tax components, is the same. The Company and the MPSC Staff have used this modified approach since the 2014 Rate Case.

Q: Did Mr. Riley propose an offsetting deferred income tax expense adjustment for the tax losses on asset disposals?

A: No. Mr. Riley did not. He is treating the tax losses like they are a permanent tax deduction that would never be recovered for book purposes and does not have a deferred income tax expense offset. Mr. Riley appears to be only including the current tax benefit on the timing difference and ignoring the deferred income tax impact.

Q: Do you agree that the ADIT benefits related to the tax losses should be included in rate base?

A: Yes. The ADIT benefits created due to the deduction of tax losses generated by an asset disposition should be and have been included as a reduction to rate base in this rate case. These amounts are included just like any other ADIT created due to other timing differences related to property assets. Therefore, customers are indeed receiving the benefit of the "tax-free loan" identified by Mr. Riley in his testimony on page 14. If, however, we do not include the deferred income tax expense in cost of service, it would not be appropriate to include the related ADIT tax benefits in rate base. For these reasons, Mr. Riley's proposal related to the tax losses being included in the income tax expense calculation should be denied.

NOL ADIT IN RATE BASE

Q: Do you agree with Mr. Riley that the ADIT-related NOL should be excluded from rate base?

A: No. Mr. Riley incorrectly asserts that the $46,090,883 ADIT asset in rate base is related to NOLs generated and used on income tax returns. And, he asserts that since EMW utilized all of its NOLs in 2020, it should no longer have ADIT related to NOLs in rate base.

The $46,090,883 asset included in rate base is not related to NOLs generated and used on income tax returns. The balance is related to the reduction of the federal corporate income tax rate in 2017 from 35% to 21% and for the reduction of the Missouri corporate income tax rate from 6% to 4%, for NOLs that EMW had at that time of the rate changes. The difference in the tax rates was not written off, instead an adjustment to the balances of EMW's ADIT assets and liabilities was computed and deferred into a regulatory asset or liability to be amortized back to customers over time. The adjustment is commonly referred to as excess deferred income taxes ("EDIT"). This ensures that customers receive the benefit of any EDIT over time.

Q: Was this issue identified and resolved in a prior rate case?

A: Yes. All EDIT balances and amortization periods related to the federal corporate rate change were determined in EMW's 2018 rate case.[1] Although EMW requested a five-year amortization period in that case to match up with when it expected to utilize the remaining NOLs as identified in Mr. Riley's testimony, the requested five-year amortization was not ordered. Instead, the Commission determined that the NOL EDIT should be amortized using the IRS's average rate assumption method ("ARAM") to match the amortization methods used for EDIT related to the depreciation deductions that generated the NOLs. The ARAM method replicates how the deferred taxes would have reversed over the book life of assets, which the depreciation deductions related to. Therefore, the NOL EDIT amortization period is expected to be over the remaining book life of the assets placed in service the year the NOLs were originally generated.

All of the EDIT balances and amortization periods, including NOLs, related to the Missouri corporate rate change were determined in EMW's 2022 Rate Case. An amortization period of four years was agreed to in the Stipulation and Agreement approved by the Commission.[2]

ESOP 401(k) DIVIDEND TAX BENEFITS

Q: Do you agree with Mr. Young that a portion of the dividends paid to Evergy's ESOP 401(k) plan should deducted when computing income tax expense for EMW?

A: EMW is not opposed to including an allocation of the dividends paid into Evergy Metro's ESOP 401(k) plan in the computation of income tax expense for EMW. However, in prior

[1] See In re KCP&L et al.'s Request for Auth. to Implement A Gen. Rate Increase for Elec. Serv., Nos. ER-2018-0145 & 46, *Order Approving Stipulations and Agreements*, at 7 (Oct. 31, 2018).
[2] See In re EMW's Request for Auth. to Implement A Gen. Rate Increase for Elec. Serv., No. ER-2022-0130, 2022 WL 4599047, *Order Approving Four Partial Stipulations and Agreements*, at *9 (Sept. 22, 2022).

rate case proceedings, the full amount of the dividends paid related to Evergy Metro employees was included in Evergy Metro's income tax expense computations. If a portion of these dividends are now included in EMW cost of service, then a similar allocation should be removed from Evergy Metro's income tax expense computation in its next rate case proceeding. EMW will include an adjustment for its portion of ESOP 401(k) dividends in its calculation of income tax expense in the true up workpapers.

Q: Please explain what tax deductions are allowed for dividends paid into an ESOP 401(k) plan?

A: Under current tax rules, an employer can deduct dividends paid into an employee stock option plan ("ESOP') even though the dividends are not allowed as a deduction for financial statement purposes. Evergy Metro's employees are allowed to purchase Evergy stock within its defined contribution retirement plan (commonly referred to as a 401(k) plan). Therefore, it qualifies as an ESOP plan. The deduction is only allowed by the company that has employees (in this case Evergy Metro). Since EMW does not have its own employees, it does not have a deduction on its own corporate tax return for these dividends. However, Mr. Young is correct that a portion of the 401(k) plan company cash contributions is allocated to EMW and the dividends paid on any stock within the plan purchased by these employees may be related to work paid for by EMW.

EDIT AMORTIZATION

Q: Do you agree with Mr. Young that amortization of EDIT should be included as an offset to total income tax expense in the current revenue requirement?

A: Yes. We agree that EDIT amortization should be included in the current revenue requirement. However, the amount of amortization should be computed using an annualized amount based on the expected amortization for 2024. The MPSC Staff workpapers have used the amortization for a twelve-month period from July 1, 2023 to June 30, 2024 to compute the amount of EDIT amortization in its case.

Q: Why would the annualized amount based on the expected amortization for 2024 be more appropriate than the twelve-month period proposed by the Staff?

A: The EDIT amortization for protected plant and net operating losses is computed using the IRS ARAM method under the normalization rules. This method uses book depreciation to estimate the amount of EDIT that would have reversed over the life of the assets it relates to. The amount of book depreciation included in cost of service in the true up of this case and used to compute the 2024 expected amortization is based on a full year of expected book depreciation and not based on the twelve-month true-up period. Therefore, it is more appropriate to use the expected 2024 EDIT amortization calculated using the expected annualized book depreciation to be consistent.

KANSAS CITY EARNINGS TAX

Q: Do you agree with Mr. Young that Kansas City earnings tax expense should be $0 in cost of service?

A: No. EMW does not agree with removing all Kansas City earnings tax expense from cost of service. While Mr. Young is correct that no earnings tax liability was paid in 2021 and 2022, we estimate that the liability for 2023 when filed will be $48,704. Alternatively, if an estimate for 2023 is not acceptable, we ask that an average of the tax due on the last three years of tax returns filed be used. The tax liability due for the 2020, 2021, and 2022 tax years was $65,403, $0, and $0, respectively. Therefore, the average of these amounts is $21,801. A three-year average of Kansas City Earnings tax was proposed by Mr. Young in Evergy Metro's 2022 rate case and could be used in this case.

PROPERTY TAX

Q: Do you agree with Ms. Lyons recommendation that the levelized property tax expense for EMW should be based on the actual property taxes paid in 2023?

A: No. In the past several general rate cases for EMW, a ratio of property tax expense to total plant-in-service for the year tax payments were known was computed and applied on the January 1 balance of plant for the year the general rate case is considered. In this case, a ratio of the 2023 property tax payments divided by the plant balance at January 1, 2023 was applied to the January 1, 2024 plant balance to estimate the level of property tax expense in EMW's direct filing. Any PILOT payments were added to this balance. This method takes into consideration any increases in plant balances that have occurred since January 1, 2023 and projects a corresponding increase in property tax expense to cover increases in expense for EMW. The Staff method does not take into account any increases in rate base since January 1, 2023. The Staff method will produce a significant shortfall for property taxes EMW expects to pay in 2024. The ratio method provides a better estimate of the actual taxes EMW expects to pay.

Any increase or decrease from the base property tax expense set in this case is expected to be deferred into regulatory asset or liability to ensure that customers only recover the actual property taxes incurred.

Q: Does that conclude your testimony?

A: Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Evergy Missouri West, Inc. d/b/a Evergy Missouri West's Request for Authority to Implement A General Rate Increase for Electric Service	))))	Case No. ER-2024-0189

AFFIDAVIT OF MELISSA K. HARDESTY

STATE OF MISSOURI)
) ss
COUNTY OF JACKSON)

Melissa K. Hardesty, being first duly sworn on his oath, states:

1. My name is Melissa K. Hardesty. I work in Kansas City, Missouri, and I am employed by Evergy Metro, Inc. and serve as Senior Director of Taxes.

2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of Evergy Missouri West consisting of eight (8) 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.

Melissa Hardesty

Melissa K. Hardesty

Subscribed and sworn before me this 6th day of August 2024.

Anthony R. Westenkirchner

Notary Public

My commission expires: 4/26/2025

ANTHONY R. WESTENKIRCHNER
NOTARY PUBLIC - NOTARY SEAL
STATE OF MISSOURI
MY COMMISSION EXPIRES APRIL 26, 2025
PLATTE COUNTY
COMMISSION #17279952