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Exhibit No. 122

Evergy Missouri West – Exhibit 122
Melissa K. Hardesty
Rebuttal
File No. ER-2024-0189

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

1 **Q: Please state your name and business address.**

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

4 **Q: Are you the same Melissa K. Hardesty who submitted direct testimony on February**
5 **2, 2024?**

6 A: Yes.

7 **Q: On whose behalf are you testifying?**

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

10 **Q: What is the purpose of your rebuttal testimony?**

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

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

3 TAX LOSSES ON ASSET DISPOSITIONS

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

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

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

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

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

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

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

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

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

21 A: Yes. The ADIT benefits created due to the deduction of tax losses generated by an asset
22 disposition should be and have been included as a reduction to rate base in this rate case.
23 These amounts are included just like any other ADIT created due to other timing

1 differences related to property assets. Therefore, customers are indeed receiving the
2 benefit of the “tax-free loan” identified by Mr. Riley in his testimony on page 14. If,
3 however, we do not include the deferred income tax expense in cost of service, it would
4 not be appropriate to include the related ADIT tax benefits in rate base. For these reasons,
5 Mr. Riley’s proposal related to the tax losses being included in the income tax expense
6 calculation should be denied.

7 **NOL ADIT IN RATE BASE**

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

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

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

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

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

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

17 **ESOP 401(k) DIVIDEND TAX BENEFITS**

18 **Q: Do you agree with Mr. Young that a portion of the dividends paid to Evergy’s ESOP**
19 **401(k) plan should deducted when computing income tax expense for EMW?**

20 A: EMW is not opposed to including an allocation of the dividends paid into Evergy Metro’s
21 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).

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

7 **Q: Please explain what tax deductions are allowed for dividends paid into an ESOP**
8 **401(k) plan?**

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

19 **EDIT AMORTIZATION**

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

22 A: Yes. We agree that EDIT amortization should be included in the current revenue
23 requirement. However, the amount of amortization should be computed using an

1 annualized amount based on the expected amortization for 2024. The MPSC Staff
2 workpapers have used the amortization for a twelve-month period from July 1, 2023 to
3 June 30, 2024 to compute the amount of EDIT amortization in its case.

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

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

14 **KANSAS CITY EARNINGS TAX**

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

17 A: No. EMW does not agree with removing all Kansas City earnings tax expense from cost
18 of service. While Mr. Young is correct that no earnings tax liability was paid in 2021 and
19 2022, we estimate that the liability for 2023 when filed will be \$48,704. Alternatively, if
20 an estimate for 2023 is not acceptable, we ask that an average of the tax due on the last
21 three years of tax returns filed be used. The tax liability due for the 2020, 2021, and 2022
22 tax years was \$65,403, \$0, and \$0, respectively. Therefore, the average of these amounts

1 is \$21,801. A three-year average of Kansas City Earnings tax was proposed by Mr. Young
2 in Evergy Metro's 2022 rate case and could be used in this case.

3 **PROPERTY TAX**

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

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

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

21 **Q: Does that conclude your testimony?**

22 A: Yes, it does.

