

Exhibit No.: _____
Issue(s): Additional Income Tax Deductions/
Possible Normalization Violations/Income Tax
Expense Lag in Cash Working Capital
Witness/Type of Exhibit: Riley/Direct
Sponsoring Party: Public Counsel
Case No.: ER-2024-0319

DIRECT TESTIMONY

OF

JOHN S. RILEY

Submitted on Behalf of the Office of the Public Counsel

**UNION ELECTRIC COMPANY
D/B/A AMEREN MISSOURI**

CASE NO. ER-2024-0319

** _____ **
Denotes Confidential Information that has been redacted.

The information that is redacted in Public Counsel witness John Riley's direct testimony is redacted because another party has identified that information to be confidential in response to a discovery request. Rule 20 CSR 4240-2.135(5)(A).

December 3, 2024

PUBLIC

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DIRECT TESTIMONY
OF
JOHN S RILEY
UNION ELECTRIC COMPANY d/b/a AMEREN MISSOURI
CASE NO. ER-2024-0319

1 **Q. What is your name and what is your business address?**

2 A. John S. Riley, PO Box 2230, Jefferson City, Missouri 65102.

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

4 A. I am employed by the Missouri Office of the Public Counsel (“OPC”) as a Utility Regulatory
5 Supervisor.

6 **Q. What is your educational background?**

7 A. I earned a B.S. in Business Administration with a major in Accounting from Missouri State
8 University.

9 **Q. What is your professional work experience?**

10 A. I was employed by the OPC from 1987 to 1990 as a Public Utility Accountant. In this capacity,
11 I participated in rate cases and other regulatory proceedings before the Public Service
12 Commission (“Commission”). From 1994 to 2000 I was employed as an auditor with the
13 Missouri Department of Revenue. I was employed as an Accounting Specialist with the
14 Office of the State Court Administrator until 2013. In 2013, I accepted a position as the Court
15 Administrator for the 19th Judicial Circuit until April 2016 when I joined the OPC as a Public
16 Utility Accountant III. I have also prepared income tax returns, at a local accounting firm, for
17 individuals and small business from 2014 through 2017.

18 **Q. Are you a Certified Public Accountant (“CPA”) licensed in the State of Missouri?**

19 A. Yes. As a CPA, I am required to continue my professional training by attending Missouri
20 State Board of Accountancy qualified educational seminars and classes. The State Board of

1 Accountancy requires that I spend a minimum of 40 hours a year in training that continues
2 my education in the field of accountancy. I am also a member of the Institute of Internal
3 Auditors (“IIA”) which provides its members with seminars and literature that assist CPAs
4 with their annual educational requirements.

5 **Q. Have you previously filed testimony before the Missouri Public Service Commission?**

6 A. Yes, I have. A listing of my case filings and certifications is attached as JSR-D-1.

7 **Q. What is the purpose of your direct testimony?**

8 A. I am proposing adjustments to the tax calculations historically utilized in Staff accounting
9 schedules to recognize an annual tax deduction Union Electric Company d/b/a Ameren
10 Missouri (“Ameren Missouri” or the “Company”) enjoys concerning losses recognized on the
11 disposition of its utility assets. I will also respond to Mr. Mitchell J. Lansford’s Supplemental
12 Direct Testimony that suggests that a normalization violation is imminent. Finally, I will
13 address the Company’s expense lead/lag concerning income taxes that is utilized in the cash
14 working capital (“CWC”) calculations.

15 **I. DISPOSITION DEDUCTION IN THE INCOME TAX CALCULATIONS**

16 **Q. What is the nature of the dispositions that you would like to include in the income tax**
17 **calculations?**

18 A. The Company discards depreciable utility assets on a regular basis. The disposition can be a
19 trade-in, a sale, a retirement, or a complete abandonment. The assets can be a wide range of
20 resources that for one reason or another is disposed of before it is completely depreciated for
21 tax purposes. The property can be nearly any asset held for utility business such as trucks,
22 utility poles, transformers, office furniture or even an entire generation plant.

1 **Q. Could you explain how these disposals are tax deductible?**

2 A. As I mentioned, these assets are depreciable property. The depreciation, whether it is straight-
3 line or accelerated, is an annual tax deductible expense. Theoretically, these assets will be
4 used and depreciated through its entire useful life and have no accounting value at disposition.
5 However, many assets do not last as long as expected. Early disposal leaves asset costs to be
6 recognized in the tax return. Under-depreciated asset retirement causes a company to
7 recognize the remaining cost as a lump sum loss. So instead of noting the gradual cost
8 allocation through annual depreciation, the remaining balance is moved to a “net gain or loss”
9 line item within the tax return.

10 Let’s use a large substation transformer as an example. A transformer is purchased for \$5
11 million and has a useful life of 20 years (\$250,000 depreciation a year) but for income tax
12 purposes it will be depreciated over 10 years (\$500,000 a year in depreciation).

13 EXAMPLE

14 \$5,000,000 asset.

15
16 Accelerated depreciation for tax purposes equals 10 years:
17 $\$5,000,000/10=\$500,000$ annual tax deduction

18
19 Straight-Line depreciation for ratemaking is 20 years.:
20 $\$5,000,000/20=\$250,000$ deduction for rates

21
22 For the sake of argument, lightning strikes the transformer near the end of year four. For tax
23 purposes, at the time of the lightning strike, the transformer has been depreciated down to \$3
24 million dollars (\$500,000 for four years equals \$2 million accumulated depreciation reduction
25 and \$5 million less \$2 million equals a \$3 million asset loss).

26 Now, for tax purposes the transformer was a \$3 million loss. In this instance, Ameren
27 Missouri records a \$3 million loss on either Form 4797, which is gains/loss on sale, or a
28 straight-out abandonment after the ruined transformer is scrapped. The advantages of either

1 avenue is not germane to this discussion. In either circumstance, the Company records a loss
2 on the tax return that translates to a tax deduction of \$3 million. Therefore, the premature
3 disposal caused by the lightning strike creates roughly a \$715,200 reduction in its tax bill. (\$3
4 million multiplied by the composite tax rate of 23.84% equals \$715,200).

5 **Q. Why should the Commission recognize this deduction when income tax is computed by**
6 **Staff for the revenue requirement?**

7 A. Depreciation is recognized in rates just as depreciation is recognized on a tax return. When
8 an asset is prematurely retired/abandoned then the depreciation stops, and a loss is recognized
9 on the tax return for the remaining undepreciated balance (\$3 million). For ratemaking,
10 depreciation stops but these losses do not get recognized in the income tax calculations used
11 for ratemaking. However, they should.

12 **Q. Does Staff typically consider these deductions in its income tax accounting schedules?**

13 A. No. I think historically it has been a focus of Staff to calculate income taxes to adhere to the
14 normalization rules and reviewing the financial statements or tax returns for other deductions
15 has not been a priority. The deductions that Staff applied to taxable income in Ameren
16 Missouri's last rate case were only Interest, Straight-line depreciation, Nuclear
17 Decommissioning and Preferred Dividends. I did not find a deduction in the income statement
18 schedule that matched the loss recorded on the tax returns.

19 Though Staff has not yet filed its accounting schedules in this case, because Staff does not
20 typically address this deduction, I am addressing it here. I will update my position in rebuttal
21 based on Staff's accounting schedules filed in this case.

22 **Q. Could you please provide a brief overview of the normalization rule?**

23 A. Congress wants companies to invest in assets in order to create jobs and foster economic
24 development. One of the ways Congress does this is to provide tax breaks as incentives to

1 spend money. The federal government allows depreciation to be accelerated to provide a tax
2 break (deduction) that is not allowed to be recognized in ratemaking tax calculations.

3 Let's review the transformer scenario again. Depreciation for rates was \$250,000 a year but
4 for the tax return it was \$500,000. The normalization rules basically state that for ratemaking,
5 taxes are calculated on revenues less the straight-line depreciation of \$250,000. For tax
6 purposes, however, it will be revenues less accelerated depreciation of \$500,000. That creates
7 a tax deferral of \$59,600 (\$500,000 less \$250,000, multiplied by the composite tax rate of
8 23.84%).

9 What this means is that, in this hypothetical scenario, the ratepayer is paying \$59,600
10 (\$250,000 X 23.84%) more in taxes each year than what the utility will owe on the tax return.
11 The IRS states that this is an interest free loan from the government, but in actuality it is a
12 government loan financed by the ratepayer because the money is coming from rates. Congress
13 wants the company to use this free loan to create economic development, so the utility pays
14 the deferred taxes back slowly over the life of the asset that generated the accelerated
15 depreciation. In our transformer example the payback time will be over the expected life of
16 the asset, 20 years.

17 **Q. What amount of losses are you proposing to include in the revenue requirement?**

18 A. Ameren Missouri has a substantial number of losses or abandonments in every year. In EF-
19 2024-0021, the Commission made a partial adjustment for the abandonment deduction for
20 Rush Island¹ that is an expected tax deduction on the 2024 federal return, which has not been
21 filed yet. What I propose is an average from the annual totals from the last four available tax
22 returns and include that in the revenue requirement as a yearly amount. The loss/abandonment
23 total for the 2023 through 2020 tax returns was **_____**. Divided by four creates
24 an average amount of **_____**.

¹ Ameren Securitization of Rush Island, Case No. EF-2024-0021

1 ** _____
2 _____**. This is a substantial tax deduction and
3 shouldn't be ignored. Otherwise, it will create a permanent windfall for the Company.

4 **Q. How would this be a permanent reduction?**

5 A. As we discovered in litigating the Rush Island securitization case, Case No. EF-2024-0021,
6 when an asset is no longer in service, it is removed from rate base along with the accumulated
7 depreciation and the associated ADIT.²

8 **Q. What are the results of removing the ADIT from rate base?**

9 A. The interest free loan is no longer recognized and therefore, the reduction to rate base is
10 eliminated. This translates to no longer paying back the ratepayer for funding of future
11 income taxes and obviously, not recognizing the tax loss created by the premature retirement
12 of the asset. For the ratepayer to be made whole, the Commission will need to order the return
13 of the funding by way of recognizing this tax deduction.

14 **Q. How would the income tax calculations be adjusted to reflect this new deduction?**

15 A. In its accounting schedules, Staff would include a new line item in the section **Subtractions**
16 **from Net Income before Taxes** to reduce taxable income by the loss/abandonment amount
17 prior to establishing the **Net Taxable Income**.

² Sections 1.167(a)-8(a), 1.168(i)-8(b)(2) and 1.167(I)-1(h)(2) provide that the accumulated ADIT balance must be adjusted to reflect dispositions. Also, in Private Letter Ruling -101888-23, page 12, third paragraph, attached as Schedule JSR-D-02, the IRS stated "the removal of public utility property from the rate base necessitated the removal of the associated ADIT under the Consistency Rule of § 168(i)(9)(B)."

1 **Q. Could you sum up your position on the early disposition of Company assets and how it**
2 **should be treated for revenue requirement income tax purposes?**

3 A. Yes. The unrecognized early retirement of an asset represents a windfall for the utility. The
4 Company can use the loss that is generated from the early disposition and keep the savings in
5 taxes for itself. This is an inequity that should be corrected. The ratepayer funded the asset
6 that was prematurely disposed of and funded the deferred taxes that were earmarked to pay
7 the future tax liability on the asset. When the future tax liability no longer exists, the ratepayer
8 should have its funding returned as soon as the retirement is recognized.

9 **II. NORMALIZATION VIOLATION**

10 **Q. Company witness Mr. Mitchel J. Lansford has pointed out in his supplemental**
11 **testimony that there could be a normalization violation. Could you explain the**
12 **circumstances?**

13 A. In the course of reviewing Private Letter Rulings (“PLR”) issued by the IRS, Mr. Lansford
14 came upon IRS decisions concerning the disposition of Net Operating Loss Carryforwards
15 (“NOLC”). Mr. Lansford explains that the essence of the controversy was that the Parent
16 Company was utilizing a subsidiary’s NOLC on the consolidated income tax returns when
17 computing taxable income and was reimbursing the subsidiary for using the loss provisions.
18 In filing for its general rate case (“GRC”), the subsidiary included its former NOLC in rate
19 base as if the Parent had never used it in the consolidated federal income tax returns. The IRS
20 determined that including the NOLC was the proper action regardless of the Parent
21 Company’s payments to the subsidiary for the use of the NOLC.

1 **Q. Do you agree with Mr. Lansford’s interpretation of the PLR or with the ruling the IRS**
2 **laid out in the PLRs that Mr. Lansford included with his testimony?**

3 A. Not entirely. How the IRS views a subject matter is often predicated by how the questions
4 are posed to the reviewer.³ Taxpayers in the instance cited by Mr. Lansford asked for rulings
5 that specifically included recognizing payments for transferring NOLC to the parent
6 company. That added condition affects the IRS’s answer.

7 **Q. What would change if the payments were ignored?**

8 A. That is a good question. In the PLR referenced by Mr. Lansford, the IRS does not take issue
9 with the parent company’s use of the subsidiary’s NOLC. Specifically, in that PLR the
10 question was posed in this manner:

11 1. Reducing Taxpayer’s stand-alone DTA by reason of the [Tax
12 Allocation Agreement (TAA)] **payments** would violate the deferred
13 tax reserve computational rules of §1.167(l)-1(h)(2).⁴

14 The IRS was not asked and never mentioned a ruling on the validity of the use of the
15 subsidiary’s NOLC in the consolidated income tax return. The IRS also never mentioned that
16 the use of the NOLC by the consolidated group was a violation of any normalization rules.
17 The IRS did not answer the obvious question: How can the consolidated group use the NOLC,
18 but also include the NOLC in rate base for the subsidiary’s next rate case?

19 **Q. How did the IRS rule on the inclusion of the NOLC in rate base?**

20 A. The IRS stated in its ruling that the NOLC must be “taken into account” when considering
21 the effect on rate base, but also acknowledges that:

³ The PLR reviewer is the IRS attorney who is assigned to answer the question posed by the taxpayer.

⁴ Mr. Lansford’s supplemental testimony, Schedule MJL-SD3, PLR-107770-22, page 8. DTA refers to Deferred Tax Asset (NOLC) and TAA refers to the Tax Allocation Agreement that governs usage of tax attributes among the Parent and subsidiaries in a consolidated tax group.

1 The tax allocation method utilized by the Parent group for financial
2 reporting reflects the NOLC (and other tax attributes) as realized or
3 realizable when it is realized or realizable by the consolidated group.
4 This methodology conforms to the requirements outlined by
5 Commission B for financial accounting and reporting (Form A and
6 Form B) in Enforcement Matter.⁵

7 As mentioned in nearly all PLRs that concern ADIT or net operating losses, to “take into
8 account” would be to recognize a relationship between the NOLC and the ADIT balance but
9 the IRS will generally admit that there is no specific defining action related to the phrase “take
10 into account”.

11 **Q. It seems that the IRS is contradicting itself. What do you think?**

12 A. Yes, it does. The IRS never mentions a prohibition on tax sharing within a consolidated tax
13 group. However, it insists that normalization violations exist for not reducing the accumulated
14 deferred income tax (“ADIT”) balance in a rate case even though the NOLC was used in the
15 consolidated tax group’s federal tax return. The IRS doesn’t care to reconcile the fact that it
16 is insisting that the same NOLC be applied twice. In fact, the PLR referenced by Mr. Lansford
17 pointed out that “how the group members allocate tax liabilities amongst themselves is
18 irrelevant to the analysis.”⁶ So it appears that the point the IRS is making is that strict
19 interpretation of the Normalization Rules finds a violation in this circumstance. However, the
20 taxpayer didn’t ask how to reconcile that conclusion with the fact that the tax asset (the
21 NOLC) had been consumed in the consolidated tax return. But you can see from the quote
22 above that the taxpayer did acknowledge that the NOLC was addressed when the parent
23 company consumed the NOLC in the consolidated tax return.

⁵ Lansford Schedule MJL-SD2, PLR-105952-22, page 6.

⁶ Schedule MJL-SD2, PLR-105952-22, page 12.

1 **Q. What is your recommendation concerning the apparent IRS position?**

2 A. I recommend that the Commission direct the Company to request clarification from the IRS
3 concerning the possible dual use of its subsidiary specific NOLC. The IRS needs to spell out
4 how an NOLC utilized in a consolidated tax return can still be an asset in a ratemaking
5 procedure.

6 **III. LEAD/LAG DAYS FOR INCOME TAX EXPENSE IN CASH WORKING CAPITAL**
7 **("CWC")**

8 **Q. Could you provide some background on what CWC calculations you are addressing?**

9 A. A concise definition often used by Staff in CWC testimony:

10 Cash Working Capital (CWC) is a rate base component that represents a
11 measurement of the amount of funds, on average, required for the **payment**
12 of a utility's day-to-day expenses, as well as an identification of whether a
13 utility's customers or its shareholders are responsible for providing these
14 funds in the aggregate.⁷ (Emphasis Added)

15
16 In a CWC calculation, both a revenue lag and an expense lag are measured. The "lag" is the
17 amount of time, usually in days, that it takes revenues to come in from the customer or the
18 time it takes for the utility to pay out an expense. Customer payments are fairly uniform, and
19 this revenue lag is a consistent multiplier in the calculation. In contrast, each expense
20 component of the CWC calculation has a different payment schedule based on when the
21 individual expense needs to be paid. As a result, the expense lag is different for each expense
22 item.

⁷ This definition is used by Staff in many of its Cost of Service Reports.

1 **Q. What did the Company include as an income tax expense component?**

2 A. Ameren Missouri applied the standard 38-day quarterly tax payment lag to income tax
3 expense.

4 **Q. Is Ameren Missouri currently in a taxable situation?**

5 A. No. Ameren Missouri is a member of the Ameren Corporation consolidated income tax
6 group, however, on a stand-alone basis, Ameren Missouri has produced taxable losses the last
7 two years. With the steady expansion of depreciable projects, I expect it to be in that same
8 situation for the foreseeable future.

9 **Q. Should the Company apply a quarterly tax payment schedule to its income tax expense
10 lag if it isn't paying taxes?**

11 A. No. A quarterly tax schedule is not indicative of the actual timing of or lack of income tax
12 payments to a federal agency.

13 **Q. What should the expense lag be for income taxes?**

14 A. If you have no cost (payments) at any time during the year, then your lag would be an entire
15 year. Thus, the expense lag should be a negative 365 days (*i.e.* one full year).⁸

16 **Q. Has the Commission recognized this 365 day lag before?**

17 A. Yes. In Spire, Inc.'s rate case, Case No. GR-2021-0108, the Commission recognized that
18 some companies are in a tax loss situation, because of that, a 365-day lag is appropriate.⁹

⁸ Ameren Missouri actually receives payments from Ameren Corporation because Ameren Missouri shares its tax losses with the consolidated group.

⁹ Amended Report and Order, 31, Case No. GR-2021-0108.

1 **Q. Could you summarize your position concerning the income tax lag in CWC?**

2 A. IRS normalization rules require taxes for ratemaking be computed and applied to the cost of
3 service even if a Company's use of tax benefits allows it to avoid tax altogether. Ameren
4 Missouri generates income tax losses yearly and it is not responsible for the payment of
5 income taxes to a taxing authority. The CWC calculation should reflect the collection but
6 nonpayment of this income tax expense.

7 **IV. CONCLUSION**

8 **Q. Could you summarize each of your recommendations in this testimony?**

9 A. Yes. Early retirement/disposals of utility assets should be recognized in the Staff's income tax
10 calculations to allow the ratepayer to benefit from the same tax deductions available to the
11 Company.

12 The IRS should be petitioned to clarify its decisions concerning possible normalization
13 violations when subsidiary NOLCs are used in consolidated income tax returns but also
14 expected to adjust the rate base balances as well.

15 The income tax CWC calculations should reflect the nonpayment of income tax expense by
16 including an expense lag of 365 days.

17 **Q. Does this conclude your Direct Testimony?**

18 A. Yes, it does.

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

In the Matter of Union Electric Company d/b/a)
Ameren Missouri's Tariffs to Adjust Its) Case No. ER-2024-0319
Revenues for Electric Service)
)

AFFIDAVIT OF JOHN S. RILEY

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

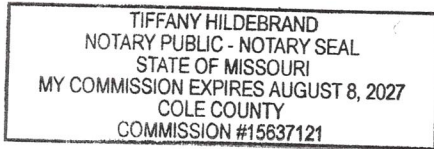
John S. Riley, of lawful age and being first duly sworn, deposes and states:

1. My name is John S. Riley. I am a Utility Regulatory Supervisor for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my direct testimony.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

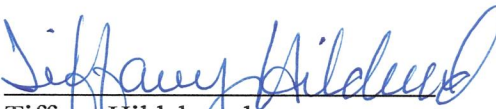


John S. Riley
Utility Regulatory Supervisor

Subscribed and sworn to me this 2nd day of December 2024.



My Commission expires August 8, 2027.



Tiffany Hildebrand
Notary Public