Exhibit No.: _____
Issue(s): Possible Normalization Violation/ Disposition Deduction/Lead Time CWC Income Tax Calculations
Witness/Type of Exhibit: Riley/Surrebuttal
Sponsoring Party: Public Counsel
Case No.: ER-2024-0319

SURREBUTTAL 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

February 14, 2025

TABLE OF CONTENTS

SURREBUTTAL TESTIMONY

OF

JOHN S. RILEY

UNION ELECTRIC COMPANY

D/B/A AMEREN MISSOURI

CASE NO. ER-2024-0319

Q. What is your name and business address?

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

Q. Are you the same John S. Riley who prepared and filed rebuttal testimony in this case on behalf of the Office of the Public Counsel?

A. Yes.

Q. What is the purpose of your surrebuttal?

A. I will be responding to Union Electric Company d/b/a Ameren Missouri ("Ameren Missouri" or the "Company") witness Mr. Mitchell Lansford concerning a possible normalization violation, a tax deduction for dispositions and the lead time on income tax in the Cash Working Capital calculations ("CWC").

NORMALIZATION QUESTION

Q. Could you summarize the concerns that you expressed in your direct testimony in this case?

A. Yes. Mr. Lansford provided three Private Letter Rulings ("PLR") that concluded that a commission's attempt to adjust the utility's deferred tax asset ("DTA") for the parent company's tax allocation agreement ("TAA") payments would violate the normalization rules

established in the IRS code. This TAA was a reimbursement to the subsidiary for the parent company's use of the net operating loss ("NOL") that was created by the subsidiary in the consolidated income tax return.

Q. Do you agree with that conclusion?

A. I agree with how the IRS framed the situation and the decision it provided in these particular PLRs. Making any sort of direct flowthrough adjustment of deferred taxes is a violation of the normalization rules. However, my concern with the wording, or lack of, in the PLRs Mr. Lansford provided is that the IRS did not address the apparent dual use of the NOL by the parent company in the tax return and the IRS's insistence that the net operating loss carryforward ("NOLC") remain in the rate base of the utility.

Q. Why didn't the IRS address the duality in the PLR?

A. Because the question posed did not address it. In my experience, the IRS answers only the question asked and draws its conclusion only based on the facts as they are presented. In the PLRs Mr. Lansford provided, the only question asked was whether the TAA payments could be factored into a rate base adjustment. The answer was "no".

Q. Mr. Lansford disagrees with your conclusion. How do you respond?

A. Mr. Lansford attempts to portray me as attacking the IRS's credibility, which I'm not doing. There is a reason why the IRS includes a disclaimer near the end of every PLR which states something very similar to:

> **Except as specifically set forth above, no opinion is expressed or implied concerning the federal income tax consequences of the above-described facts under any other provision of the Code or regulations.**

> **This ruling is directed only to the taxpayer requesting it. Section 61 10(k)(3) of the Code provides that it may not be used or cited as precedent.**
>
> **This ruling is based upon information and representation submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.**[1]

So to be clear, my concerns are: Adjusting rate base to reflect the TAA payments is a normalization violation on its own. But, how can the NOLC in question be absorbed by the parent company in the annual consolidated income tax return yet that same NOLC still be considered in rate base for the subsidiary's rate cases?

I did not see that contradiction posed in any of the three PLRs that Mr. Lansford included in his testimony. The IRS is very specific. I am not suggesting the IRS is unknowledgeable or lacks due diligence. I am saying the IRS didn't answer my question because the taxpayers who requested the PLRs didn't *ask* my question.

Q. Is there another aspect of this situation that should be recognized?

A. Yes. Normalization is meant to allow a company to take advantage of deferred tax and not let it flow-through directly to the ratepayer, which would defeat the purpose of the interest free loan. Accepting the parent company's use of the NOL prevents the flow-through to the ratepayer just as if the NOL was used by the subsidiary utility. Look at it this way. If the utility made a profit and applied the NOL to its own taxable income no one would claim a

[1] PLR -101888-23, final page ruling section, paragraphs 2,3 and 4

violation. Why should the use by the parent company, which is, in essence, an extension of the utility, be ignored and claimed a violation?

Q. Mr. Lansford has pointed out in his testimony that you provide no support for your claim. How do you respond?

A. Apparently, Mr. Lansford hasn't had the opportunity to watch the PLR process from start to finish. I would point back to a recent decision by the Public Service Commission of the State of Missouri (the "Commission"), the PLR that was generated from that decision, and the subsequent corrections due to how the facts and question were posed to the IRS in requesting that PLR.

Abbreviated History

Case No. WO-2019-0184 Missouri-American Water Company (the "Surcharge case")

Company claimed that due to the lack of revenues created by the Infrastructure System Replacement Surcharge ("ISRS") and the already recognized depreciation, the Company sustained an NOL for the Surcharge case. The Commission disagreed and ruled against recognizing an NOL in the accumulated deferred income tax ("ADIT") pertaining to the Surcharge case. MAWC requested a PLR and Mr. David J. Yancey from Deloitte Tax LLP filed the necessary paperwork with the IRS. (JSR-S-01Confidential)

In requesting the PLR, Mr. Yancey stated as a fact that the NOLC existed, stating:

> In the course of the Surcharge Case, Taxpayer and other participants in the proceeding, including Commission staff, analyzed the expenditures for which Taxpayer sought recovery via the Surcharge **and debated the proper regulatory treatment of Taxpayer's NOLC and tax loss incurred through the rate base determination date of the Surcharge Case** with respect to the costs incurred that are recoverable in the Surcharge Case. The revenue requirement approved in Commission's order issued on December 5, 2018, was lower than

> the revenue requirement ultimately sought by Taxpayer (after resolution of non-tax matters) by $886,917 and is entirely attributable to differing ADIT calculations with respect to the NOLC and the resulting effects on rate base and allowed return. The approved revenue requirement in the Surcharge Case was based on a rate base computation that reflect the gross ADIT liabilities associated with depreciation-related and repair-related book/tax differences, **but did not reflect an ADIT asset for any portion of Taxpayer's NOLC as of the date that rate base was determined (i.e., November 30, 2018), including the tax loss resulting from the infrastructure expenditures addressed in the Surcharge Case.**[2] (Emphasis added)

The Company requested:

> If the Service rules as Taxpayer has requested with respect to issue #5 and holds that ADIT resulting from repair-related book/tax differences is not subject to the normalization requirements, Taxpayer requests that the Service also rule: **Under the circumstances described above, in order to comply with the normalization method of accounting within the meaning of § 168(1)(9) of the Code, the amount of depreciation-related ADIT reducing rate base used to determine the revenue requirement set in the Surcharge Case must be decreased to reflect a portion of the NOL for the test period for the Surcharge Case** which would not have arisen had Taxpayer not reported depreciation-related book/tax differences during the test period for the Surcharge Case and such decrease in depreciation-related ADIT must be an amount that is no less than the amount computed using the With-and-Without Method.[3] (Emphasis added)

Long story short. The IRS determined that there was a normalization violation due to the nonrecognition of an NOL that occurred in the Surcharge case. (JSR-S-02confidential)

[2] Mr. Yancey's formal request to the IRS included as JSR-S-01, 3rd section: Facts Relating to Request for Private Letter Ruling, page 6,

[3] Request No. 9 of the formal request for a PLR (JSR-S-01)

The OPC appealed the case to the Western District Court of Appeals (WD83924, JSR-S-03), where all the facts were considered. The Western District denied the notion that an NOL was created in the Surcharge case and remanded the case back to the Commission.

The IRS came to an incorrect decision due to being provided the incorrect information. This caused the agency to be incorrect on two counts. It was not apprised of all the facts, and the normalization violation it was to rule on did not exist. Further, it was not supplied with the information that the NOL was not created from all expenses measured against all company revenues.

It is apparent that Mr. Lansford has not had the opportunity to view the PLR procedure from start to finish. If he had, he would realize that the IRS is very narrow in its focus when addressing a PLR question. The limited scope in the three PLRs is the reason why I am suggesting another PLR to resolve the duality question.

Q. Could you please summarize your position on this topic?

A. I am requesting that the Commission order Ameren Missouri to apply for a PLR where the subject matter of the PLR encompasses the question of the dual use of the NOL created by the subsidiary where the parent company has used the NOL in the consolidated income tax return, yet the deferred asset remains on the subsidiary's books for ratemaking purposes.

EARLY DISPOSITION LOSS DEDUCTION

Q. Could you provide a brief recap of this issue?

A. Yes. In the normal course of business, Ameren Missouri (all utilities) disposes of regulated utility property. Disposition can be referred to as early retirement, obsolete technology, damaged assets, etcetera. Any reason to remove regulated assets from the books prior to the exhaustion of the tax depreciation benefits. The early removal can create a profit but normally

the Company records a loss on the disposition. This loss is recorded on the tax return and provides a tax deduction for the Company. I am petitioning the Commission to recognize these early dispositions and instruct Staff to include these tax deductions in its Accounting Schedules.

Q. How does Staff and the Company state that these disposition losses should be treated in the revenue requirement?

A. Witness Lansford explains in his rebuttal testimony that both Company and Staff include these deductions in the revenue requirement by way of the normalization method.

Q. Please provide an explanation of this method.

A. This reference to the normalization method is the general amortization of deferred taxes back to the ratepayer over time as opposed to the immediate flow-through as the deduction occurs. Put another way, deferred tax is returned to the ratepayer over time through rates. That is the normalization. If the asset was subject to accelerated depreciation, then the amortization timeframe is the life of the asset. If it is any other depreciated expense/asset then the timeframe is usually much quicker.

Q. Is this normalization the proper method to return this deduction to ratepayers?

A. No. The IRS has stated that the asset, accumulated depreciation and the associated ADIT must be removed from rate base. This assertion will be revealed in one of the IRS quotations below.

Q. Mr. Lansford stated that you made a false claim concerning the handling of the disposed asset's ADIT.[4] How do you respond?

A. Mr. Lansford spent a great deal of time stating that I'm wrong, I'm lying or generally attacking my integrity, but as can be seen throughout this surrebuttal testimony, authoritative guidance shows the validity of my positions. Mr. Lansford mentioned a PLR that I referenced when I contended that the asset's ADIT should be removed from rate base. He stated it had no relevance to this case. The PLR is 101888-23. I quoted parts of this PLR earlier in my testimony, but I will include the entire PLR as JSR-S-04 for the Commission's consideration. I'll also add some additional pertinent quotes below that I think make the IRS's determination clear on the asset/ADIT relationship:

> Section 1.167(l)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that the aggregate **amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under section 1.167(1)-1(h)(1)(i) or to reflect asset retirements** or the expiration of the period for depreciation used for determining the allowance for depreciation under section 167(a).[5](Emphasis added)

And from page 11:

> Section 1.168(i)-8(b)(2) provides that, for purposes of § 1.168(i)-8, **a disposition occurs when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer's trade or business or in the production of income. A**

[4] Lansford rebuttal, page 23, lines 7-11 through line 12 of page 24

[5] PLR-10888-23, page 10, third paragraph

> **disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset.** (Emphasis added)

And from page 12:

> **Additionally, 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).** That rule requires that any estimate or projection used to determine a taxpayer's tax expense, depreciation expense, rate base or the reserve for deferred taxes under § 168(i)(9)(A)(ii) must also be used for the other normalization elements for ratemaking purposes.
>
> The ADIT at issue was created by the deferral of federal taxes attributable to Taxpayer's claiming accelerated depreciation with respect to the condemned property as required by § 1.167(I)-1(h)(2). The disposition of the condemned property in the Condemnation is the functional equivalent of a retirement of such property in the hands of Subsidiary C and Subsidiary D. Following the Condemnation, both Subsidiary C and Subsidiary D became non-operating entities, ceased to hold any "public utility property," and were no longer subject to the cost of service/rate of return ratemaking jurisdiction of Commission A. **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 such as the Condemnation. Accordingly, since all of Subsidiary C's assets and Subsidiary D's assets were disposed of in the Condemnation, the entire ADIT balance attributable thereto must be removed as well and may not be transferred to the new owners of the condemned property.** (Emphasis Added)

And finally, the pertinent RULING in this PLR:

> The failure to eliminate the deferred taxes, including ADIT and the deferred tax reserves on the regulated books of Subsidiary C and Subsidiary D as of the date of the Condemnation, attributable to public utility property condemned in a transaction governed by § 1033 would violate the normalization provisions of § 168(i)(9).

Though Mr. Lansford attempts to distinguish this PLR because it addresses condemnation and transfer of property between affiliates, as can be seen in several lines of these quotations; the

IRS does not differentiate between condemnations, dispositions, sales or any other method of removing the asset from rate base. For instance, the IRS stated on page 12, "The disposition of the condemned property in the Condemnation *is the functional equivalent of a retirement of such property in the hands of Subsidiary C and Subsidiary D*." (emphasis added). Further, the quotations show that disposition is broader than the transfer of assets. Specifically, the IRS pointed out on page 11 that "Section 1.168(i)-8(b)(2) provides that, for purposes of § 1.168(i)-8, a disposition occurs when ownership of the asset is transferred *or* when the asset is permanently withdrawn from use either in the taxpayer's trade or business or in the production of income." (emphasis added). It continued saying, "[a] disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset."

Mr. Lansford also stated that I was referencing a rule that only applies to Missouri's Securitization Statute. He also stated that "Outside securitization, the Company's unrecovered investment in an asset remains in rate base as a component of the depreciation reserve that also remains in rate base, along with the associated ADIT."[6] It is my understanding that the Commission does not allow retired plant to remain in rate base.[7] If that is correct, it stands to reason that the associated ADIT should be removed also.

Q. As referenced in the PLR, it appears that the normalization method of returning orphaned ADIT is in fact, a normalization violation. What are you proposing should be done?

A. If the Commission concludes that the ADIT must be removed, then the only way the ratepayer is made whole for loaning money to the utility to pay taxes that we now know will never be

[6] Lansford rebuttal, page 24, lines 5-7
[7] I think retired, disposed or discarded plant is no longer considered used and useful and usually is excluded from rate base.

paid, is to apply the disposition deduction to the net income and reduce the income tax calculated in this case.

Q. Has any other utility incorporated these tax losses for retirements into its income tax calculations?

A. Yes. Apparently, Missouri-American Water ("MAWC") has performed these calculations for at least the last two rate cases. Company witness Ms. Linda Schlessman pointed out in testimony from Case No. WR-2024-0320 that the Company adjusted current income taxes for these deductions. "The Company did include within the current tax expense calculation a tax deduction for property, plant, and equipment retirements in the amount of $7,049,382"[8]

INCOME TAX LEAD TIME IN THE CASH WORKING CAPITAL CALCULATIONS ("CWC")

Q. Mr. Lansford claims that the Company makes quarterly tax payments and therefore should be afforded a lead time of less than 365 days. Does the Company make quarterly payments?

A. The real question is: If the entity had to file a separate tax return, would this Company be required to pay income tax? In 2021 and 2022 Ameren Missouri would not. In 2023 it would. Judging from Mr. Lansford's Figure 9 on the last page of his rebuttal testimony, in 2024 Ameren Missouri did not have taxable income. Three out of the last four years, Ameren Missouri would not have been required to pay income tax. I think it is well established that if

[8] WR-2024-020, Schlessman, Rebuttal/Surrebuttal/Sur-Surrebuttal Testimony page 4, lines 8-9

a Company does not expect to owe income tax then it is not required to pay quarterly. If it does pay quarterly and then subsequently files a return where it did not have taxable income, then it would be due a refund.

Q. Will the fact that Ameren Missouri had taxable income in one year muddy the calculations?

A. You could make that argument, however, Ameren Missouri is currently requesting no less than three new generating facilities to be included in rate base. The bump in accelerated depreciation should create taxable losses until at least the next time the Company comes in for its next rate case.

Q. Mr. Lansford illudes to a normalization violation by way of double counting and therefore an accelerated recovery of ADIT. Is this occurring?

A. No. The Commission made it clear in the Spire case that CWC is a measurement of the daily cash needs of the Company to pay its expenses. The income tax for CWC is the current income tax calculated by Staff. The Commission recognized that the current income tax, which was properly calculated to avoid any normalization violations was being collected and not being paid to a government authority, hence the 365 day lead.

Q. Could you please summarize your testimony?

A. There are two reasons the Commission should find that Ameren Missouri will not pay any income tax prior to its next case. The first is the large amount of rate base that is coming on-line in this rate case and in the near future that will create enough expense to negate any taxable income. Secondly, the Company is arguing that a NOLC should remain on its books per an IRS PLR. An NOL would be used in the near future to reduce any taxable income. Combining an increase in accelerated depreciation with a current NOL should safely deflect any taxable income until the next rate case. A 365 lead time should remain.

Q. Does this conclude your surrebuttal testimony?

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 Revenues for Electric Service	))))	Case No. ER-2024-0319

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 surrebuttal 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 11th day of February 2025.

TIFFANY HILDEBRAND
NOTARY PUBLIC - NOTARY SEAL
STATE OF MISSOURI
MY COMMISSION EXPIRES AUGUST 8, 2027
COLE COUNTY
COMMISSION #15637121

Tiffany Hildebrand
Notary Public

My Commission expires August 8, 2027.