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

II. NORMALIZATION VIOLATION

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

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

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

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

Q. What would change if the payments were ignored?

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

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

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

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

A. The IRS stated in its ruling that the NOLC must be "taken into account" when considering 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.

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

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

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

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

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

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

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

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

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.