FILED
October 23, 2025
Missouri Public
Service Commission

Exhibit No. 38

Empire District Electric Company – Exhibit 38
Testimony of Michael McCuen
Direct
File No. ER-2024-0261

Exhibit No.: _____
Issue: Taxes
Witness: Michael McCuen
Type of Exhibit: Direct Testimony
Sponsoring Party: The Empire District Electric Company d/b/a Liberty
Case No.: ER-2024-0261
Date Testimony Prepared: November 2024

Before the Public Service Commission
of the State of Missouri

Direct Testimony

of

Michael McCuen

on behalf of

The Empire District Electric Company d/b/a Liberty

November 6, 2024

Liberty™

TABLE OF CONTENTS
FOR THE DIRECT TESTIMONY OF MICHAEL MCCUEN
THE EMPIRE DISTRICT ELECTRIC COMPANY D/B/A LIBERTY
BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2024-0261

SUBJECT **PAGE**

DIRECT TESTIMONY OF MICHAEL MCCUEN
THE EMPIRE DISTRICT ELECTRIC COMPANY D/B/A LIBERTY
BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2024-0261

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Michael McCuen. My business address is 602 South Joplin Avenue, Joplin, Missouri 64802.

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

A. I am employed by Liberty Utilities Service Corp. ("LUSC") as the Director of U.S. Tax Planning and Strategy. LUSC is a direct subsidiary of Liberty Utilities Co. ("LUCo") and is a subsidiary of Liberty Utilities (Canada) Corp. ("LUCC"), which is a wholly owned subsidiary of Algonquin Power & Utilities Corp. ("APUC"). APUC is the ultimate parent company of The Empire District Electric Company d/b/a Liberty ("Liberty" or "Company").

Q. On whose behalf are you testifying in this proceeding?

A. I am testifying on behalf of Liberty.

Q. Please describe your educational and professional background.

A. I received a Bachelor of Business Administration degree in Accounting from Franklin University in 1992. I received a Juris Doctor degree from Capital University Law School in 2000. I am a Certified Public Accountant in the State of Ohio and licensed to practice law in the State of Ohio. I held various accounting and tax positions through 2007. In 2007, I joined Mettler-Toledo as U.S. Tax Manager with responsibility for all income tax matters for their U.S. subsidiaries. In 2012, I was named Head of U.S. Taxation for Mettler-Toledo with responsibility for all tax matters within the U.S. I joined NiSource Corporate Services Company, a management and services subsidiary of NiSource Inc. in May 2012 as Director of Income Taxes. I have performed work for Liberty since January 2021 as both the Senior Tax Manager and, starting September 20, 2021, in my current position as Director, U.S. Tax Planning & Strategy.

Q. Have you previously testified before the Missouri Public Service Commission ("Commission") or any other regulatory agency?

A. Yes, I have submitted testimony before this Commission. I have also testified before the Indiana Utility Regulatory Commission, the Public Service Commission of Maryland, the New York State Public Service Commission, and the Public Utilities Commission of Ohio.

Q. What is the purpose of your direct testimony in this proceeding?

A. The purpose of my direct testimony is to discuss the impacts of Internal Revenue Service ("IRS") Private Letter Rulings ("PLR") released since the last rate case specific to the normalization requirements around how utilities treat Cost of Removal ("COR") within their Excess Accumulated Deferred Income Tax ("Excess ADIT") calculations. In addition, I discuss the impacts of similar rulings around normalization requirements pertaining to "Protected Excess ADIT" tracker mechanisms, and I identify the risks and a suggested solution for Liberty.

II. PRIOR ORDERS

Q. Has the Commission issued an Order related to the Tax Cuts and Jobs Act ("TCJA") for Liberty?

A. Yes. The Commission issued its Amended Report and Order on July 23, 2020, in Case No. ER-2019-0374 addressing the impacts for TCJA. In the Amended Report and Order, at page 104, Finding of Fact #275 states: "The balance of the protected excess

ADIT is $101,146,004 and the balance of the unprotected excess ADIT is $25,621,649 as of March 31, 2019." Finding of Fact #278 at page 104 goes on to state: "Neither Empire nor the Commission can accelerate the return or amortization of the protected portion of excess ADIT without violating IRS normalization rules. The protected portion of excess ADIT will flow back to the customers over the average remaining life of the assets." Finally, the Amended Report and Order stated in pertinent part at page 107 explains the Commission's decision on the issue:

> In ER-2018-0366 evidence showed that improperly calculating the return of protected excess ADIT could result in a mismatch that could result in a normalization violation under IRS regulations. Accordingly, the Commission cannot order a specific amortization period for the protected portion of excess ADIT. The adjustment to amortize protected excess ADIT in this case is $2,263,671. This amount must periodically be recalculated and amortized over the life of specific assets, which due to retirements and other unforeseeable conditions may change over time. The Commission shall order Empire to return the protected amount of excess ADIT as amortized over the average remaining life of asset compliant with IRS normalization principles. Empire shall submit those amounts in its next rate case so that the Commission may determine compliance.

Q. Can you please generally describe what is meant by Protected Excess ADIT?

A. Protected Excess ADIT is the portion of Excess ADIT associated with accelerated depreciation tax timing differences that must be "normalized" for ratemaking purposes. "Tax normalization" effectively means the utility receives immediate benefit from the accelerated depreciation tax timing difference, with that benefit then being gradually passed on to customers over the estimated life of the utility asset giving rise to the accelerated depreciation deduction. As mentioned above under the TCJA, the Commission is restricted from flowing back Protected Excess ADIT to customers in rates any more quickly than over the estimated remaining life of the assets that gave rise to the ADIT.[1]

Q. Can you please generally describe what is meant by Unprotected Excess ADIT?

A. Unprotected Excess ADIT is the portion of the utility's deferred tax reserve that resulted from normalization treatment of tax timing differences other than accelerated depreciation deductions. Unprotected Excess ADIT can be flowed back to customers through an amortization period of the Commission's choosing.[2]

Q. Has there been any new guidance issued by the IRS that would impact the Protected Excess ADIT subject to the Order in Case No. ER-2019-0374?

A. Yes. The IRS has issued new guidance around the treatment of COR and the use of tracker mechanisms for Protected Excess ADIT. I have listed below a few examples of new guidance issued since the Order in Case No. ER-2019-0374:

1. PLR 202033002: COR-related deferred tax assets and liabilities are not subject to normalization.
2. PLR 202124003: COR-related deferred taxes are not subject to the normalization rules.
3. PLR 202141001: Gross removal cost-related differences are not subject to the normalization rules.
4. PLR 202211004: Including COR in the Average Rate Assumption Method ("ARAM") calculation for the return of EDIT attributable to depreciation to ratepayers is inconsistent with the normalization requirements.
5. PLR 202230005: Including removal costs in the return of the federal EADIT to ratepayers under ARAM is inconsistent with the normalization rules. Excluding removal costs in the return of the EADIT to ratepayers under ARAM is consistent with the normalization rules.
6. PLR 202142002 (Tracker): The Normalization Rules of § 168(i)(9), former § 167(I), and § 13001(d) of the TCJA do not permit Taxpayer to adjust its EADIT ARAM amortization based on the test year to the EADIT ARAM amortization based on one or more subsequent years without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense.

---

[1] Staff Report Regarding The Effects Upon Missouri Utilities Of The Tax Cuts And Jobs Act Of 2017, File No. AW-2018-0174.
[2] Id.

Q. Does this guidance impact the total amount of Excess ADIT that was calculated and identified in the previously quoted Report and Order from Case No. ER-2019-0374?

A. No. The originally calculated amounts are not impacted. However, the classification of Protected versus Unprotected is impacted and the timing of the pass back of Protected is impacted as well, which I explain in further detail below.

The Company's Excess ADIT has been returned to customers faster (more rapidly) than permitted under what the ARAM allows due to COR being embedded in book depreciation expense. A normalization violation occurs if Excess ADIT is used to reduce rates more rapidly than would have occurred if tax reform had not occurred. Therefore, to cure a potential normalization violation, the Company is proposing to use a hybrid method by leaving historical balances the same but removing the COR component of book depreciation rates on a prospective basis. This would ensure that book COR would not generate a faster reversal of Excess ADIT than allowed and would comply with the Internal Revenue Code and avoid any normalization concerns.

III. COST OF REMOVAL

Q. Please provide a summary of how COR is handled for regulatory reporting.

A. For regulatory reporting, the Company accounts for its annual depreciation expense using the following components (1) book depreciation, (2) estimated COR (determined based on a depreciation study), and (3) salvage. The purpose of including a COR component in depreciation rates is to recover both the original cost of Property, Plant, and Equipment ("PP&E") over its estimated life as well as having customers who benefit from the PP&E pay for the estimated removal costs (net of estimated salvage, if any). COR is a component of establishing the applicable book composite depreciation rate and is collected from customers over the estimated book life of the asset.

Q. Please provide a summary of how COR is handled for tax purposes.

A. For tax purposes, actual COR is deductible when actual removal costs are paid. Liberty includes its customer collections (revenue) that fund the COR reserve as taxable income over the operating life of an asset, claiming an offsetting tax deduction, if applicable, at the end of the asset life. This COR book/tax timing difference creates a deferred tax asset ("DTA"). The COR-related DTA is included in Liberty's overall plant related accumulated deferred income taxes ("ADIT") and recorded in FERC Account 282. Similarly, the COR-related Excess ADIT is netted against other plant-related Excess ADIT balances within the Company's tax software (PowerTax), including those balances derived from tax method and life depreciation method differences. It should be noted the Excess ADIT amount related specifically to COR is unknown as PowerTax is set up to include COR as part of the method/life plant deferred tax liability ("DTL"), not as an individual component.

Q. What is the IRS rule around normalization and cost of service?

A. TCJA § 13001(d)(1) provides that a normalization method of accounting shall not be treated as being used (i.e., a normalization violation may occur) with respect to any public utility property for purposes of §167 or §168 if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under ARAM. As such, this section of the normalization rules applies to Excess ADIT that is related to protected depreciation method and life differences.

Q. How has Liberty historically treated Excess ADIT related to COR?

A. Liberty has historically treated the Excess ADIT on COR as a Protected book-tax difference. As noted previously, the total amount of Excess ADIT has not changed and is not impacted.

Q. Has the IRS issued guidance related to COR?

A. Yes. The IRS issued multiple PLRs addressing the treatment of COR as it pertains to normalization and ARAM. In PLR 202141001, the IRS held that accrued gross COR included within the book depreciation expense and the subsequent tax deduction were not subject to normalization rules (not Protected) as set forth under IRC § 168(i)(9). Similarly, the associated Excess ADIT attributable to COR is not subject to normalization rules under TCJA § 13001(d). Therefore, making COR differences Unprotected versus Protected.

Q. If recent IRS guidance has concluded that COR is Unprotected and Liberty has historically treated the ADIT and Excess ADIT related to that book-tax-difference as Protected, what is the issue you are addressing?

A. The issue concerns how the ARAM amortization has been calculated. Under ARAM, the Excess ADIT amortization amount is determined when book depreciation reverses. Liberty has been calculating the ARAM amortization using the book depreciation rate, which contains factors to recover both depreciation expense over the estimated book life, as well as the COR. By calculating the ARAM amortization using the combined depreciation rate, the amortization of Excess ADIT using ARAM is occurring too rapidly, which does not comply with the Internal Revenue Code normalization rules.

Q. Can you illustrate the issue with an example?

A. Yes. Assume a $1 million fixed asset is placed in service and has an estimated book life of 10 years. Annual depreciation expense in years one to ten to recover that fixed asset would be $100,000 ($1 million divided by 10 years = $100,000). The annual depreciation rate applied to the fixed asset cost is 10% (1 divided by 10 = 10%). In addition, it is estimated that when the asset is retired after year 10, a removal cost of $50,000 will be incurred. To recover the estimated COR from the customers who are using that fixed asset, an expense of $5,000 each year is necessary, which is recorded as a component of depreciation expense. Thus, annual depreciation expense to recover both the fixed asset cost over the estimated book life plus an estimated COR factor is $105,000. Converting this annual expense into a rate to apply to the fixed asset cost yields a composite rate of 10.5%.

The issue at hand concerns the rate used to calculate ARAM. Liberty has been using the 10.5% composite depreciation rate instead of the life-only rate of 10%. In this manner, the Excess ADIT is being amortized too quickly and Liberty must slow that amortization so that the ARAM rate reflects the life-only factor rate.

Said another way, if Liberty were to continue using the composite rate, which is higher than the life-only factor of the rate, the Protected Excess ADIT will be returned to customers before the fixed asset is fully depreciated, posing a potential normalization violation.

Q. What is Liberty proposing in this rate case to avoid the potential normalization violation?

A. The Company proposes that the ARAM amortization for Protected Excess ADIT be based on the life-only rate rather than the total depreciation rate. Utilizing this life-only rate will assure that Liberty complies with the revised IRS guidance.

IV. TRACKER MECHANISMS

Q. Does the Company currently have a tracker mechanism for Excess ADIT?

A. Yes. In Case No. ER-2021-0312, the Commission issued an Order Approving Stipulations and Agreements, which approved a Non-Unanimous Partial Stipulation and Agreement on Rate Base and Net Operating Income Agreements.[3] Under paragraph 6 of the Commission-approved stipulation, the parties agreed as follows:

> EADIT Tracker: A tracker will be created to capture the difference between protected EADIT returned to customers as part of the revenue requirement in this case, and the actual amortization recorded by the Empire using ARAM for protected EADIT balances and a 3-year amortization period for non-stub period unprotected EADIT balances.

Q. What is the concern with this tracker?

A. The IRS has issued numerous PLRs specific to the normalization requirements around how utilities treat true ups within their Excess ADIT calculations. The IRS has ruled that the Consistency Rule in IRC §168(i)(9)(B)(i) precludes taxpayers from adjusting one aspect of ratemaking under the normalization rules without the others. See PLR 202142002. The Consistency Rule requires that the reserve for ADIT, tax expense, and book depreciation expense must be consistent. This PLR extends that concept to Excess ADIT to find that a public utility could not adjust its amortization of Excess ADIT using the ARAM without making similar adjustments to its ADIT, book depreciation, and tax expense.

[3] Case No. ER-2021-0312, Order Approving Stipulations and Agreements, eff. March 19, 2022, approving Non-Unanimous Partial Stipulation and Agreement (filed January 28, 2022).

Currently, the Company's Excess ADIT Protected tracker does not take into account adjustments to ADIT, book depreciation, and tax expense. Therefore, the Company's Excess ADIT Protected tracker is inconsistent and creates a potential normalization violation.

Q. Does this tracker concern apply to both Protected and Unprotected Excess ADIT?

A. No. Former § 167(I) of the Internal Revenue Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they use a normalization method of accounting. Section 1.167(I)-1(a)(1) of the Income Tax Regulations provides that normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing tax expense and depreciation expense for purposes. Therefore, these regulations do not pertain to other book-tax timing differences with respect to state income taxes or any other taxes and items. Said another way, only the property method life portion, considered Protected, is subject to normalization rule violations and is at issue with this tracker.

Q. Does the Company's tracker mechanism for Unprotected Excess ADIT comply with the IRS rules?

A. Yes. Since the normalization rules only apply to Protected Excess ADIT, the Company's tracker mechanism for Unprotected Excess ADIT is valid and has no IRS issues.

Q. Based on the IRS guidance, what is the impact to Liberty?

A. Liberty has agreed to a specific amount of Protected Excess ADIT to pass back to customers annually. The Company's Excess ADIT Protected tracker is a true-up mechanism that is intended to make customers whole by tracking the amount in base rates versus the actual amount. The IRS specifically addressed this issue in PLR 202142002 and found:

> …providing a true-up to EDIT ARAM amortization in the year following the rate year based on volume variances between the test year and the rate year without making similar adjustments to rate base, ADIT, book depreciation expense, and tax expense likewise is not in compliance with the Consistency Rule. The true-up mechanism adjusts for volume differences only with respect to one item, EDIT amortization. This results in the use of estimated volumes in setting rates for all items other than EDIT reversal which uses actual volumes. This treatment is an inconsistent use of estimates or projects not allowed by section 168(i)(9)(B).

Because all the components required to comply with the Consistency Rule do not exist in the Company's Excess ADIT Protected tracker, Liberty is at risk of violating the Normalization Consistency Rules.

Q. How does the Company propose the Excess ADIT Protected tracker be changed to avoid violating the Normalization Consistency Rules?

A. The Company proposes that the current Excess ADIT Protected tracker must either be terminated or be amended to include the various components necessary to comply with the Normalization Consistency Rules.

V. CONCLUSION

Q. What is your conclusion related to COR?

A. Liberty's Excess ADIT amortization has been returned to customers faster (more rapidly) than permitted under the ARAM due to COR being embedded in book depreciation expense. To correct this potentially inadvertent normalization violation, Liberty must change how it calculates the amortization of Excess ADIT going forward. Prospectively, the ARAM amortization for Protected Excess ADIT will be based on the life-only rate rather than the total depreciation rate. Utilizing this life-only rate will assure that Liberty complies with the revised IRS guidance.

Q. What is your conclusion related to the Protected Excess ADIT tracker mechanism?

A. Both Liberty and the Commission intend at all times to comply with the Normalization Rules. Therefore, any inadvertent failure should be corrected at the earliest available opportunity. The Company's current Excess ADIT Protected tracker must be terminated or amended to include the various components necessary to comply with the Normalization Consistency Rules.

Q. Has the Company reflected these proposals inside the revenue requirement filed in this case?

A. Yes. For further discussion regarding the Company's proposed Excess ADIT adjustments, please refer to RB ADJ 9, RB ADJ 10, and EXP ADJ 7 in the direct testimony of Charlotte T. Emery.

Q. Does this conclude your direct testimony at this time?

A. Yes.

VERIFICATION

I, Michael McCuen, under penalty of perjury, on this 6th day of November 2024, declare that the foregoing is true and correct to the best of my knowledge and belief.

/s/ Michael McCuen