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Witness/Type of Exhibit:

Sponsoring Party:

Case No.:

Tax Gross Up
Riley/Rebuttal
Public Counsel
WR-2025-0345

REBUTTAL TESTIMONY

OF

JOHN S. RILEY

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

FILE NO. WR-2025-0345

January 16, 2026

REBUTTAL TESTIMONY
OF
JOHN S. RILEY
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2025-0345

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 direct testimony in this case on behalf of the Office of the Public Counsel (“OPC”)?

A. Yes.

Q. What is the purpose of your rebuttal?

A. I will be responding to Missouri-American Water Company (“MAWC” or the “Company”) witness Ms. Linda Schlessman and Mr. Brian LaGrande concerning the exclusion of a calculated income tax gross-up on the revenue requirement.

Q. Ms. Schlessman contends that income taxes expenses are not a deduction. Do you disagree?

A. No. Taxes are not a deduction, but that admission does not affect the OPC’s position. The OPC’s point is that MAWC currently collects income taxes, but does not pay them to the government at this time. It makes no difference in this calculation if the taxes are a deduction. It makes a difference if the expense is currently being paid. The customers fund this expense, but MAWC doesn’t forward the money to the government for years to come.

Q. Explain again the purpose of a tax gross-up.

A. A tax gross-up is an additional calculation to ensure that a company has the opportunity to earn the allowable income established by the Commission in a rate case. As Ms. Schlessman pointed out, taxes are not a deduction. They are additional taxable revenues. In theory, tax needs to be calculated on this additional revenue. However, as I stated in direct testimony, the Company does not owe any current taxes so a gross-up is unnecessary.

Q. Ms. Schlessman points out that “If the Company does not pay the government immediately for the tax (known as current tax expense) it must record a liability for the future payment of the tax (known as deferred income tax expense).”¹ Are these unpaid current income taxes recorded as deferred taxes and deducted from rate base?

A. No. Only the calculated deferred (ADIT) portion of the taxes that are derived from plant additions are included as an offset to rate base².

The ratepayer gets no benefit from MAWC’s unpaid current income taxes.

¹ Schlessman direct, page 4, lines 8 - 11

² A quick tutorial on ADIT or Accumulated Deferred Income Tax. ADIT is calculated from plant additions or repairs to plant assets. It is accumulated by recognizing the accelerated tax depreciation and subtracting straight-line depreciation. The IRS allows certain repair expenses to be capitalized and deducted similar to plant additions. The differences are then multiplied by the composite tax rate of 23.84% to provide an ADIT balance. (\$1000 accelerated tax deduction vs \$500 of straight-line depreciation. \$500 difference is multiplied by 23.84% to equal \$119.20 deferred tax (ADIT)). This accumulated balance is then used to offset rate base.

Current income tax liability, however, isn’t included in rate base.

1 **Q. Could you explain how deferred tax (ADIT) is different from deferring current income**
2 **tax?**

3 A. As I pointed out above, deferred taxes in a ratemaking situation is Accumulated Deferred
4 Income Tax known as ADIT. This is a plant (asset) calculation that is performed and updated
5 with each case. ADIT is typically a long lived tax advantage that is included in rates and the
6 funding is supplied by the ratepayer. The ratepayer is loaning out money interest-free so the
7 ADIT balance is used to offset (reduce) rate base to allow the ratepayer to realize a benefit.
8 This reduction in rate base is used in the rate of return (ROR) calculation.

9 Current taxes which are deferred means that the net income is calculated and the current
10 income tax rate is applied (\$100 net income X 23.84% tax = \$23.84 in current income tax).
11 The deferral comes from the fact that MAWC does not have to pay current income taxes to
12 the government. The expectation though is that sooner or later, these current income taxes
13 will be paid to the government, so a liability account is established to recognize this eventual
14 payment. This deferral of current income tax isn't offsetting rate base. It can be a liability on
15 MAWC's books for as long as it needs to be.

16 So the difference between these two tax items is that ADIT is created by plant additions and
17 capitalized repairs, while current income tax is created by a tax rate applied to regulatory net
18 income. Current tax gets deferred because the federal income tax return, or at least the
19 subsidiary's portion of the tax return, does not have taxable income. Though it is deferred in
20 the sense that it is not immediately paid to the government, it is very different from ADIT.

21 **Q. Does the calculation of ADIT include a gross up?**

22 A. No. Appendix C to MAWC's Application in this case includes a worksheet entitled "Deferred
23 Tax." (*see* JSR-R-01) On that worksheet, it shows that to calculate ADIT, the deferred tax
24 portion of the calculation, MAWC multiplied the "Book/Tax Depreciation Temporary

1 Difference” for each of its water and sewer service divisions by the corporate tax rate 23.84%.
2 This 23.84% is the corporate tax rate only and does not include a gross-up amount.

3 **Q. Ms. Schlessman also points out that a “Corporate Alternative Minimum Tax was**
4 **recently implemented and will require MAWC to make cash payments (current tax**
5 **expense) to the parent to be paid to the government.”³ Should this have any bearing on**
6 **this discussion of a tax gross-up for WSIRA additions?**

7 A. No. If this minimum tax were to be recognized here, then the parties should just skip the
8 WSIRA income tax calculations derived from rate base rate of return income and, instead
9 should calculate a minimum tax and insert it in the spreadsheet. But this isn’t the appropriate
10 venue for a base tax determination. A minimum tax calculation should be addressed in a
11 general rate case.

12 **Q. Mr. LaGrande quotes the WSIRA statute on page 8 of his direct testimony. He mentions**
13 **“appropriate pre-tax revenues” and highlights sections (a) and (b) which concern pretax**
14 **weighted cost of capital and taxes applicable to the WSIRA revenues. Is he making a**
15 **substantial argument for a tax gross-up calculation?**

16 A. No. His WSIRA statute quotations solidify my argument.

17 **Q. How so?**

18 A. The key word in the statute is “appropriate”. One definition from Oxford Languages is
19 “suitable or proper in the circumstances.” Merrian-Webster defines it as “to set apart for or
20 assign to a particular purpose or use.” No one is making the argument that income taxes
21 shouldn’t be collected in a WSIRA rate case. But the statute doesn’t mention a gross-up

³ Schlessman direct, page 5, lines 10-12

calculation. A gross-up is only “appropriate” to ensure that a company has the opportunity to earn the income that is allowed by the Commission. If the pre-tax calculations will not require additional tax to ensure that the Company is given the opportunity to earn the income allowed by the Commission, then the additional calculation is not appropriate and should be excluded.

Q. Both Ms. Schlessman and Mr. LaGrande insist that both deferred tax, commonly referred to as ADIT, and current income tax need to be considered together when considering the revenue requirement. Does referring to both deferred and current tax together change anything about your argument?

A. No. If you review the WSIRA revenue requirement page⁴ used by all three parties in this case, deferred tax is a reduction to rate base (lines 6 and 14) before calculating the revenue requirement.

Utility Plant Projects--Replacement					
Utility Plant in Service--Replacement	\$104,168,644	\$31,170,709	\$74,080	\$1,692,381	\$137,105,814
Net Contributions in Aid of Construction	2,166	(47,587)	(8,922)	(12,682)	(67,026)
Deferred Taxes	(12,802,502)	(4,032,072)	(9,459)	(262,997)	(17,107,029)
Accumulated Depreciation	(1,010,656)	(323,611)	(1,863)	(19,302)	(1,355,432)
Total Net Replacement Rate Base	\$90,357,652	\$26,767,439	\$53,837	\$1,397,400	\$118,576,327

Utility Plant Projects--Facilities Relocations					
Utility Plant in Service--Relocations	\$3,074,101	\$3,755,676	\$0	\$0	\$6,829,777
Net Contributions in Aid of Construction	(553,860)	(402,768)	0	0	(956,628)
Deferred Taxes	(600,296)	(799,301)	0	0	(1,399,597)
Accumulated Depreciation	(17,120)	(22,704)	0	0	(39,823)
Total Net Relocation Rate Base	\$1,902,826	\$2,530,904	\$0	\$0	\$4,433,729

The ROR/tax calculation doesn't occur until line 33.⁵

⁴ Attached as JSR-R-02, line 6 Deferred Taxes are a deduction to rate base

⁵ The OPC includes here its suggested pre-tax rate of return: 8.12%.

31	Total WSIRA Rate Base	\$92,260,478	\$29,298,342	\$53,837	\$1,397,400	\$123,010,057
32						
33	Overall Pre-Tax Rate Of Return per Last Order	8.12%	8.12%	8.12%	8.12%	8.12%
34						
35	Revenue Requirement on Capital	\$7,491,551	\$2,379,025	\$4,372	\$113,469	\$9,988,417
36	Depreciation Expense	1,865,036	610,129	2,599	30,935	2,508,699
37	Property Taxes	0	0	0	0	0
38	Revenue requirement at 8.47%					12,927,651
39	Total Revenue Requirement at 8.12%	\$9,356,587	\$2,989,155	\$6,971	\$144,403	\$12,497,116
40				Difference		430,535

My argument uses a non-gross-up pretax rate of return of 8.12%. Therefore, my argument considers both current taxes (included in the 8.12% pre-tax rate of return shown in line 33) and the deferred taxes (shown in line 6 & 14).

Q. How should the Commission view the issue?

A. There are several viewpoints. The first is that this isn't a one-size-fits-all determination. If a company is a current payer of income tax, then by all means, the Commission should include the gross-up calculation. In that scenario, the gross up is needed to ensure that the company has the opportunity to earn its allowable income set by the Commission. However, if the company does not currently pay income taxes, then the gross-up should not be included. It is a case-by-case decision based on whether a company pays current taxes.⁶

The Company makes the argument that these unpaid taxes will become a liability and will come due sometime in the future. However, if the Commission allows the gross-up yet the company does not currently pay current taxes, then essentially the ratepayer will pay this gross-up twice. This is so because under MAWC's proposal current taxes will be collected along with a gross-up but they are not paid to the IRS. I contend that when MAWC changes to a situation where it will pay taxes to the IRS, Staff will recognize that in MAWC's general

⁶ This is exactly what the Commission does with income tax calculations in the Cash Working Capital component. If the company doesn't pay tax to the IRS then the expense lag is 365 days. If it does pay current taxes, then the lag reflects a quarterly payment schedule which ends up being close to 38 days.

1 rate case and it will be reflected in rates along with a gross-up. Therefore, the Company will
2 essentially receive two gross-ups: (1) when its ratepayers paid the taxes plus a gross-up, but
3 MAWC didn't pay the taxes to the IRS and (2) when its customers paid the taxes plus a gross-
4 up, but MAWC did pay the taxes to the IRS.

5 Returning to the situation in this case, these unpaid (deferred) current income taxes are not
6 offsetting rate base and reducing revenue requirement. Rather, these millions of dollars are
7 free cashflow to do with as MAWC chooses. There is no cost of capital advantage provided
8 to the ratepayer, as there is with ADIT when it reduces rate base. The time value (free use)
9 of this money is all with MAWC.

10 **Q. Could you summarize your position?**

11 A. A gross-up calculation should be included only when it is appropriate. Should a gross-up be
12 included because the unpaid tax expense will come due sometime in the future? In theory,
13 ADIT comes due in the future and as pointed out earlier, no gross-up is specifically calculated
14 on the deferred tax portion of the income tax. My argument applies that same logic to current
15 income taxes that are deferred. So, I argue that no gross-up should be included.

16 Staff may well argue that this calculation has always been completed in both rate and
17 infrastructure cases, so it will continue to do so. That's not a justification. A gross-up
18 calculation should be a case by case decision and should not be added if the additional revenue
19 is not needed to allow the company the opportunity to earn its current authorized income.

20 Because MAWC does not currently pay income taxes to the government, the Commission
21 should not include a gross-up on the current income taxes in this case.

22 **Q. Does this conclude your testimony?**

23 A. Yes, it does.

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

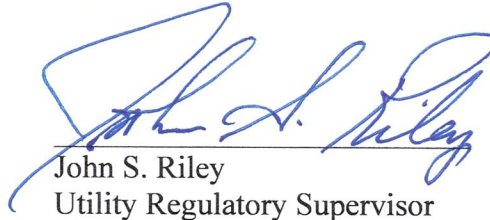
In the Matter of the Petition of Missouri-)
American Water Company for Approval to)
Establish a Water and Sewer Infrastructure Rate) Case No. WR-2025-0345
Adjustment (WSIRA))

AFFIDAVIT OF JOHN S. RILEY

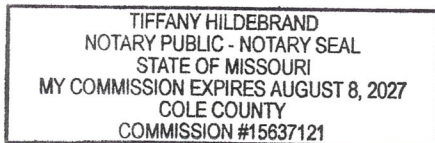
STATE OF MISSOURI)
) ss
COUNTY OF COLE)

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 rebuttal 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 14th day of January 2026.



My Commission expires August 8, 2027.


Tiffany Hildebrand
Notary Public