

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

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

**MAWC’S BRIEF**

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**COMES NOW** Missouri-American Water Company (“MAWC” or “Company”), and, as its *Brief*, states as follows to the Missouri Public Service Commission (“Commission”):

## **INTRODUCTION**

Cost of service in the revenue requirement includes income tax expense based on the obligation to pay the government both today and tomorrow. The tax expense owed to the government is not deductible now or in the future. Thus, a tax gross-up is included so the Company is not harmed by the inability to deduct income tax expense. Because not all the tax collected in the cost of service will be paid immediately to the government, an accumulated deferred income tax liability is recorded and reduces rate base, which in turn reduces the revenue requirement.

The Commission should order the pre-tax return of 8.47%, agreed to by MAWC and Staff, to ensure the Company’s after-tax return is consistent with the WSIRA statutes and the Stipulation and Agreement approved by the Commission (and supported by the Office of the Public Counsel (“OPC”)) in the Company’s last rate case (Case No. WR-2024-0320).

## **ISSUE**

### **Should the gross-up on income taxes be included in the WSIRA revenue requirement?**

Yes. A tax gross-up is a fundamental ratemaking principle and the WSIRA statutes require inclusion of the state, federal, and local income or excise taxes applicable to such revenues.

### **Background**

Staff’s total recommended revenue requirement, with which MAWC agrees, is \$15,567,151. This includes \$12,927,651 of revenue requirement on new investments and \$2,639,500 of under collection from the WSIRA reconciliation. (Ex. 1, LaGrand Dir., p. 3, ln. 16-18). It can also be broken down as follows: the incremental pre-tax revenue amount of \$12,279,215

from St. Louis County water customers, \$3,079,305 from All Other water customers, \$1,861 from Arnold sewer customers, and \$206,769 from All Other sewer customers for a total of \$15,567,151. (Ex. 202, Amended Staff Rec., p. 2).

On December 9, 2025, OPC filed a response in which it disagreed with Staff's inclusion of the gross-up on income taxes. OPC recommends a reduction of \$430,535, or a total revenue requirement of \$15,136,615. (Ex. 1, LaGrand Dir., p. 4, ln. 10-11, p. 5, ln. 3).

### **Difference Between MAWC/Staff and OPC**

A foundational concept in utility ratemaking is the calculation of the Revenue Requirement, which at a high-level is *(Rate Base x Pre-Tax Return) + Expenses = Revenue Requirement*. In this case, there is no disagreement amongst the parties regarding the Rate Base or the Expenses. The only disagreement is over the proper Pre-Tax Return. MAWC and Staff agree the Pre-Tax Return should be 8.47%. (Ex. 1, LaGrand Dir., p. 5, ln. 15 – p. 6, ln. 2; Ex. 202, Amended Staff Rec., App. C). OPC believes the Pre-Tax Return should be 8.12%. (Ex. 1, LaGrand Dir., p. 6, ln. 4; Ex. 300, Riley Dir., Sched. JSR-D-2, p. 2).

The difference is fully attributable to the income tax gross-up: MAWC and Staff use a tax gross-up of 1.3130. (Ex. 1, LaGrand Dir., Sched. BWL-3; Ex. 202, Amended Staff Rec., App. C). OPC uses a tax gross-up of 1.2384. (Ex. 300, Riley Dir., Sched. JSR-D-2, p. 2).

### **Income Tax for Ratemaking Purposes**

The Commission has described the difference between the income tax calculation for Internal Revenue Service and rate making purposes as follows:

The [Internal Revenue Code] requires the normalization of depreciation expense and the use of straight line depreciation for utility regulatory ratemaking when accelerated depreciation is used for income tax purposes. Accelerated depreciation allows earlier recognition of depreciation expense than straight line depreciation. Both depreciation methods result in a plant value of zero at the end of its useful life. The cumulative amount of income taxes paid over time compared to the income

taxes included in rates demonstrates that customers are typically contributing moneys above what is being paid for income taxes. This difference between income taxes actually paid and income tax expense included in utility rates is quantified as [Accumulated Deferred Income Taxes].<sup>1</sup>

(emphasis added).

The cash tax rate is not used because cash taxes are based on differences in timing of deductions (known as tax timing differences) between book accounting and the tax return. However, regardless of timing, the deduction is the same and does not change the amount that is taxed. (Ex. 4, Schlessman Reb., p. 3, ln. 1-4; Tr. 31, ln. 14-23 (Schlessman)).

MAWC witness Schlessman used an example to illustrate that both depreciation methods result in a plant value of zero at the end of the useful life of plant. That example is described on p. 3 of Ms. Schlessman's Rebuttal Testimony (Ex. 4) and appears in spreadsheet form on p. 4. As shown by this example, what is ultimately owed and currently payable are different, but equal over the life of the timing difference. (Ex. 4, Schlessman Reb., p. 4, ln. 8-9).

### **Income Tax Gross-Up**

Federal income tax expense is not deductible for federal income tax purposes and state income tax expense is not deductible for state income tax purposes. Therefore, when considering a revenue requirement for regulated rate-making purposes, the tax expense collected in rates must be adjusted to cover the required tax on the dollars collected in rates for tax expense. This is referred to as a tax gross-up. (Ex. 3, Schlessman Dir., p. 3, ln. 19-23).

A tax gross-up is a fundamental ratemaking principle. (Ex. 3, Schlessman Dir., p. 6, ln. 14). It is needed for establishing the revenue requirement in a general rate case as well as the WSIRA. (Ex. 3, Schlessman Dir., p. 4, ln. 3-4). OPC witness Riley accurately states that "in

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<sup>1</sup> *In the Matter of Confluence Rivers Utility Operating Company, Inc.'s Request for Authority to Implement a General Rate Increase*, Case No. WR-2023-0006, Report and Order, p. 17 (Issued October 25, 2023).

ratemaking, the Commission intends for the utility to retain \$100,000 after taxes are calculated. Therefore, additional money is included in the revenue requirement to ensure the Company keeps \$100,000 after taxes.” (Ex. 300, Riley Dir., p. 3, ln. 4-7).

The tax gross-up supported by the Company and Staff ensures the utility retains the Commission authorized amount of income tax expense. Below is an example showing that if the Commission authorized \$100 of income tax expense, using the Company’s tax gross-up of 1.3130 will result in \$100 being available for tax expense. (Ex. 4, Schlessman Reb., p. 2, ln. 1-8). It also shows that using OPC’s tax gross-up of 1.2384 will only result in \$94 being available for tax expense in the same example.

	MAWC/Staff	OPC
Income Tax Expense in Rates	\$100.00	\$100.00
Tax Gross Up	1.3130	1.2384
Total Revenues	\$131.30	\$123.84
Income Taxes 23.84%	(31.30)	(29.52)
<b>Available for Income Tax Expense</b>	<b>\$100.00</b>	<b>\$94.32</b>

OPC incorrectly assumes that the gross-up of taxes is only necessary for the Company to immediately pay the liability to the government. However, this is not the case. The gross-up is necessary for the Company to pay the liability both today (current tax expense) and in the future (deferred tax expense). (Ex. 3, Schlessman Dir., pp. 5-6).

For this reason, Staff in prior WSIRA cases (and ISRS cases) has consistently applied the tax gross-up methodology used by the Company and Staff in this case. (Tr. 41, ln. 16-25 (Majors)). Nothing has changed in the way Staff has calculated the pre-tax rate of return. (Tr. 47, ln. 25 – Tr. 48, ln. 10 (Majors)).

Moreover, Staff witness Majors confirmed that a utility will not recover adequate revenues to be made whole without including the additional income tax gross-up dollars. (Tr. 49, ln. 6-12

(Majors)). This is because the only time there is an opportunity to recover the gross-up is at the point of initial ratemaking treatment there is no opportunity to recover the gross-up when the tax is paid. (Tr. 38, ln. 15-19 (Schlessman)).

### **ADIT**

Tax expense collected by the Company in the revenue requirement does not belong to the Company – it has an obligation to pay the taxes to the government. 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). In either case, the Company must include both the current and deferred components of tax expense in the revenue requirement because they are either immediately due to the government or will be due to the government in the future. (Ex. 3, Schlessman Dir., p. 4, ln. 7-14).

Tax expense includes both current and deferred taxes. The absence of current tax expense does not mean the Company is not in a taxable situation. The Company has deferred tax expense which it must pay to the government in the future and therefore has taxes to collect from customers. Each dollar of tax collected in the revenue requirement will also be taxed. (Ex. 3, Schlessman Dir., p. 5, ln. 2-7).

When a Company incurs deferred income tax expense, these amounts are accumulated in a liability called Accumulated Deferred Income Taxes, or ADIT. (Ex. 3, Schlessman Dir., p. 4, ln. 16-18). ADIT is a dollar-for-dollar reduction to rate base that benefits customers, resulting in a lower revenue requirement. (Ex. 3, Schlessman Dir., p. 4, ln. 18-19; Ex. 4, Schlessman Reb., p. 8, ln. 20 – p. 9, ln. 2). In this case, ADIT reduces the rate base by \$18,506,626. (Ex. 1, LaGrand Dir., Sched. BWL-2). As a result, it provides a benefit to customers by reducing the revenue requirement by \$1,567,511. (*Id.*)

OPC witness Riley alleges that customers get no benefit from the tax gross-up in the current situation. (*See* Ex. 301, Riley Reb., p. 2, ln. 7-13). It is correct that only the deferred tax expense is added to ADIT (no gross-up) and it is also the case that when the deferred tax is paid, only the deferred tax expense is removed from ADIT (no gross-up). (Tr. 35, ln. 18 – Tr. 36, ln. 10; Tr. 38, ln. 3-14 (Schlessman)). However, customers are not harmed by the collection of the gross-up prior to the payment being made to the government. This is because the gross-up on the deferred taxes portion is credited to customers in the revenue requirement with the ADIT reduction to rate base. In other words, the revenue requirement is lower not just because of the ADIT balance, but also because of the gross-up on the revenue credit on the ADIT balance. (Tr. 32, ln. 4-16 (Schlessman)).

The Company's Exhibit 5 provides a demonstration of this impact to the benefit of customers. The exhibit looks at the pieces separately. When you look at the ADIT in isolation, you see that it is reducing rate base and being multiplied by the rate of return. By doing so, the credit is also grossed up. This serves to acknowledge there is a piece of the gross-up that has been collected that has not yet been remitted to the government and, consequently, there is a gross-up credit associated with that piece in the revenue requirement. (Tr. 33, ln. 9 – Tr. 34, ln. 5 (Schlessman)).

### **Commission Treatment of Current Federal or State Income Tax Treatment**

OPC witness Riley argues that there should be no tax gross-up because "MAWC does not currently owe income taxes to the IRS . . . ." (Ex. 300, Riley Dir. p. 2, ln. 13-14; p. 7, ln. 3-4, 5 ln. 12-13; p. 8, ln. 15; p. 10, ln. 5-7).<sup>2</sup> This is a fundamentally flawed position as what is ultimately owed and currently payable are different, but equal, over the life of the timing

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<sup>2</sup> While no part of the gross-up methodology relies on the current payment of income tax, MAWC and its parent, American Water Works Company ("AWWC") are required to make Corporate Alternative Minimum Tax ("CAMT") payments starting with the 2024 tax return. That return was filed in October of 2025. AWWC's CAMT was \$151.6M with MAWC's stand-alone CAMT being \$16.0M.<sup>5</sup> The CAMT resulted in an additional payment of \$84.0M above

difference. Because the Company has an obligation to pay the government in the future, a deferred tax liability is recorded on the balance sheet to signify that obligation. (Ex. 4, Schlessman Reb., p. 4, ln. 8-11).

The Commission has also recognized that the calculation of income taxes for ratemaking purposes is not directly related to what taxes may, or may not, be paid by a utility. The Commission described that process as follows:

Income tax expense, a hypothetical construct used in ratemaking, is the result of multiplying the rate base by the Commission authorized rate of return and then the statutory tax rate. This provides the utility recovery of the income tax expense associated with its authorized return on its investment.

Staff in prior Confluence Rivers' rate cases has consistently applied this methodology for income tax expense. This is the only income tax expense included in rates and there is no component within that methodology that considers the actual revenues or deductions reported on federal or state income tax returns.<sup>3</sup>

(emphasis added).

Staff witness Majors also confirmed there is no part of the gross-up methodology that considers the actual revenues or deductions reported on federal or state income tax returns. (Tr. 42, ln. 1-4 (Majors)).

### **Statutory Provisions**

Section 393.1506(1), RSMo, states that an eligible utility “. . . may file a petition and proposed rate schedules with the commission to establish or change a WSIRA that will provide for the recovery of the appropriate pre-tax revenues associated with the eligible infrastructure system projects . . . .”

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the regular tax liability for AWWC, of which MAWC's share was \$7.7M. The Company estimates that it will be in an alternative minimum tax payment situation for the next three years. (Ex. 3, Schlessman Dir., p. 5, ln. 10-13; Ex. 4, Schlessman Reb., p. 5, ln.1-9).

<sup>3</sup> *In the Matter of Confluence Rivers Utility Operating Company, Inc.'s Request for Authority to Implement a General Rate Increase*, Case No. WR-2023-0006, Report and Order, p. 16 (Issued October 25, 2023).



OPC witness Riley attempts to argue the Commission should take an expansive interpretation or the use of the word “appropriate” in the statute. (Ex. 301, Riley Reb., p. 4, ln. 18 – p. 5, ln. 4). Based on his dictionary reading of the definition of “appropriate”, he suggests that inclusion of a gross-up should be a “case-by-case decision based on whether a company pays current taxes.” (Ex. 301, Riley Reb., p. 6, ln. 9-11).

However, there is no need to interpret the word “appropriate” in this context because Section 393.1503(1), RSMo, expressly defines “appropriate pre-tax revenues” as “the revenues necessary to produce net operating income equal to:”

- (a) **The water or sewer corporation's pretax weighted cost of capital** multiplied by the net original cost of eligible infrastructure system projects, including recognition of accumulated deferred income taxes and accumulated depreciation associated with eligible infrastructure system projects which are included in the petition to establish or change a WSIRA, plus accumulated deferred income taxes and accumulated depreciation associated with any eligible infrastructure system projects in a currently effective WSIRA implemented pursuant to sections 393.1506 and 393.1509;
- (b) **The state, federal, and local income or excise taxes applicable to such revenues; . . . .**

(emphasis added)

Further, Section 393.1509.4, RSMo, states that “[i]n determining the appropriate pretax revenues, the commission shall consider only the following factors:”

- 1. The **current state, federal, and local income or excise tax rates**, including any income tax deductions; . . . .

(emphasis added)

The WSIRA statutes require inclusion of the state, federal, and local income or excise taxes applicable to such revenues. State and federal taxes are not deductible for tax purposes and therefore a gross-up is required for proper inclusion in the revenue requirement. The exclusion of

a gross-up on the taxes would indicate that they are not being fully collected as required by statute. (Ex. 3, Schlessman Dir., p. 6, ln. 15 – p. 7, ln. 5).

OPC witness Riley also suggests in a footnote that an example of his “case-by-case” analysis may be found in the Commission’s treatment of taxes within Cash Working Capital. (Ex. 301, Riley Reb., p. 6, FN. 6). However, this suggestion ignores the Commission’s discussion of the difference between the calculation of income tax and its cash working capital treatment:

In addition, OPC’s proposed income tax expense tracker seeks to compare the tracked amount to the actual income taxes paid by Spire Missouri. However, the utilization of a 365-day expense lag for income taxes in Cash Working Capital (CWC), as set out below, would also compensate customers for paying the income tax expense when no income taxes are actually paid and is an adjustment to rate base. To allow an income tax expense tracker in addition to the CWC 365-day income tax expense lag would overcompensate customers. Therefore, the Commission denies OPC’s request for an income tax expense tracker.<sup>4</sup>

(emphasis added).

### **Prior Commission Order**

In MAWC’s last rate case (Case No. WR-2024-0320), the Commission approved a 7.00% after-tax return for use in WSIRA.<sup>5</sup> The Company will not meet its authorized after-tax rate of return of 7.00% using the 8.12% pre-tax rate of return as proposed by OPC. (Ex. 3, Schlessman Dir., p. 6, ln. 2-4). This is supported by the calculation below that compares the after-tax return result using the OPC’s proposed pre-tax rate of return and the Company’s proposed pre-tax rate of return. The OPC’s proposed pre-tax rate of return of 8.12% results in an after-tax rate of return of 6.73%. Comparatively, the MAWC pre-tax rate of return of 8.47% results in the authorized after-tax rate of return of 7.00%. (Ex. 3, Schlessman Dir., p. 6, ln. 4-9).

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<sup>4</sup> *In the Matter of Spire Missouri Inc. ’s d/b/a Spire Request for Authority to Implement a General Rate Increase*, Case No. GR-2021-0108, Amended Report and Order, p. 26 (Issued November 12, 2021).

<sup>5</sup> *In the Matter of Missouri-American Water Company’s Request for Authority to Implement General Rate Increase*, Case No. WR-2024-0320, Report and Order, pp. 8-9, 30 (Third Stipulation) (Issued May 7, 2025) (See Third Stipulation, p. 2).

		MAWC/Staff	OPC
Rate Base		\$123,010,057	\$123,010,057
Pre-Tax Rate of Return		8.47%	8.12%
Pre-Tax Return		\$10,418,952	\$9,988,417
Interest Expense	2.30%	(\$2,829,231)	(\$2,829,231)
Taxable Income		\$7,589,721	\$7,159,185
Income Taxes	23.84%	(\$1,809,389)	(\$1,706,750)
Net Income		\$5,780,331	\$5,452,436
Interest Expense		\$2,829,231	\$2,829,231
After Tax Return		\$8,609,562	\$8,281,667
<b>After Tax Rate of Return</b>		<b>7.00%</b>	<b>6.73%</b>

The tax gross-up simply ensures that tax expense is properly included in the revenue requirement so that the Company can earn its authorized rate of return. (Ex. 3, Schlessman Dir., p. 7, ln. 9-10).

The Commission should order the pre-tax return of 8.47%, agreed to by MAWC and Staff, to ensure the Company's after-tax return is consistent with the Stipulation and Agreement approved by the Commission (and supported by OPC) in the Company's last rate case, Case No. WR-2024-0320.

### CONCLUSION

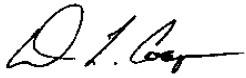
Removing the tax gross-up rate from the pre-tax rate of return would prohibit the Company from having an opportunity to earn its authorized after-tax rate of return. The exclusion of a gross-up on the taxes would indicate that they are not being fully collected as required by statute. The Company will file and pay its taxes properly as required by the IRS regardless of the inclusion or exclusion of a gross-up in ratemaking. The gross-up simply ensures that tax expense is properly included in the revenue requirement so that the Company can earn its authorized rate of return. (Ex. 3, Schlessman Dir., p. 7, ln. 4-5, 7-10, 12-13).

The Commission should reject OPC's recommended adjustment, approve the use of the 8.47% pre-tax rate of return, and adopt the WSIRA revenue requirement of \$15,567,151

recommended by Staff and supported by the Company. (Ex. 3, Schlessman Dir., p. 7; Ex. 2, LaGrand Reb., p. 4)

**WHEREFORE**, MAWC respectfully requests the Commission consider this *Brief* and issue such orders as it should find to be reasonable and just.

Respectfully submitted,



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**ATTORNEYS FOR MISSOURI-AMERICAN WATER COMPANY**

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the above and foregoing document was sent via electronic mail on this 9<sup>th</sup> day of February, 2026, to:

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