

Exhibit No.  
Issues: Income Tax Cost of Service and  
Deferred Taxes  
Witness: L. Jay Williams  
Type of Exhibit: Rebuttal Testimony  
Sponsoring Party: Empire District Electric  
Case No. ER-2016-0023  
Date Testimony Prepared: April 2016

**Before the Public Service Commission  
of the State of Missouri**

**Rebuttal Testimony**

of

**L. Jay Williams**

**April 2016**



**SERVICES YOU COUNT ON**

Empire Exhibit No. 26  
Date 6-2-16 Reporter KKF  
File No. ER-2016-0023



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L. JAY WILLIAMS  
ON BEHALF OF  
THE EMPIRE DISTRICT ELECTRIC COMPANY  
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MISSOURI PUBLIC SERVICE COMMISSION  
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1 **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS**

3 A. L. Jay Williams. My business address is 602 S Joplin Avenue, Joplin, MO.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am employed by The Empire District Electric Company (“Empire” or “Company”) as  
6 Regulatory Tax Manager.

7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK**  
8 **EXPERIENCE.**

9 A. I graduated from Missouri Southern State University with a BS in Business Administration  
10 (emphasis in accounting) in 1975. I hold certificate 8047 from the Missouri State Board of  
11 Accountancy. Prior to joining Empire in 1983, I spent 6 years in public accounting,  
12 primarily in the income tax field. Except for a short period in Empire’s Internal Auditing  
13 Department, I have spent my entire tenure in the tax area of the Company. My tax  
14 experience at the Company includes the responsibility for tax compliance in the areas of  
15 property, sales/use, corporate franchise and income taxes.

16 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE THE MISSOURI**  
17 **PUBLIC SERVICE COMMISSION (“COMMISSION”)?**

18 A. Yes.

1 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

2 A. I will respond to Staff's disallowance of previously flowed through tax benefits of costs of  
3 removal and state income tax expense. I will also respond to the Staff's computation of  
4 income and property tax cost of service and deferred taxes used to adjust rate base.

5 **FLOW THROUGH OF TAX BENEFITS OF COSTS OF REMOVAL**

6 **Q. PLEASE EXPLAIN THE TERM "FLOW THROUGH" IN TERMS OF THE**  
7 **INCOME TAX CALCULATION AND THE REGULATORY RATEMAKING**  
8 **PROCESS.**

9 A. The "flow through" of income tax deduction benefits occurs when a deduction reduces  
10 current taxable income on the company's tax return and also is used to reduce the overall  
11 tax expense component in the regulatory ratemaking process with no offsetting increase to  
12 deferred income taxes. This was a common practice throughout the industry years ago,  
13 although it has been considered a poor ratemaking practice now for more than a decade.

14 **Q. PLEASE EXPLAIN HOW COSTS OF REMOVAL WERE PREVIOUSLY FLOWED**  
15 **THROUGH IN THE INCOME TAX EXPENSE COMPUTATION.**

16 A. Costs of removal incurred in addition to the amount deducted as a component of depreciation  
17 were deducted by staff in the tax component of the cost of service computation. No  
18 deferred tax expense was allowed in the cost of service for this additional Cost of Removal  
19 incurred deduction. This flowed through the tax benefits of the Costs of Removal Incurred  
20 to ratepayers.

21 **Q. HAS EVIDENCE BEEN PROVIDED TO STAFF OF THE FLOW THROUGH OF**  
22 **THESE BENEFITS?**

1 A. Yes. Copies of Staff work papers from Empire's 1994 and 1997 cases were provided to Staff  
2 in DR 178 in Case No. ER-2012-0345, showing the flow through of the Cost of Removal  
3 tax benefits to Empire's ratepayers.

4 **FLOW THROUGH OF TAX BENEFITS OF STATE INCOME TAX EXPENSE**

5 **Q. HOW DID THE FLOW THROUGH OF STATE INCOME TAX BENEFITS OCCUR?**

6 A. The normalization requirement of the Internal Revenue Code specifies that to comply, the  
7 federal statutory rate must be used in determining deferred income tax expense. The  
8 additional component of the composite federal and state rate in excess of the federal  
9 statutory rate was not required under normalization rules.

10 **Q. HAS THE COMPANY EVER BEEN ORDERED TO USE THE COMPOSITE**  
11 **FEDERAL AND STATE RATES IN DETERMINING DEFERRED TAX IN RATE**  
12 **CASES?**

13 A. No. In fact, the Company has only been ordered to provide deferred taxes at the federal rate.

14 **Q. HAS A COPY OF THIS ORDER BEEN PROVIDED TO STAFF?**

15 A. Yes. A copy of this order was provided in our response to DR 177 in Case No. ER-2012-  
16 0345.

17 **Q. WHEN DID THE COMPANY START DEFERRING TAXES AT THE**  
18 **FEDERAL/STATE COMPOSITE RATE IN ITS BOOKS AND RECORDS?**

19 A. The Company began deferring tax at the composite rate with rates that went into effect in  
20 August, 1994.

21 **Q. WHAT IS THE COMPANY SEEKING TO COLLECT REGARDING THE FLOW**  
22 **THROUGH OF STATE INCOME TAXES?**

1 A. Similar to the cost of removal flow through, the Company seeks to collect the state portion of  
2 income tax expense that was previously deducted in determining rates but was not provided  
3 for in determining deferred taxes.

4 **EXCLUSION OF CERTAIN DEFERRED TAX ASSETS FROM RATE BASE**

5 **Q. WHAT DEFERRED INCOME TAX ASSETS WERE EXCLUDED IN**  
6 **DETERMINING RATE BASE IN THE STAFF'S INITIAL FILING?**

7 A. Staff excluded the deferred tax assets related to FAS 123 (stock based compensation), Net  
8 Operating Loss Deduction, and Alternative Minimum Tax.

9 **Q. WHAT IS FAS 123?**

10 A. FAS 123 is an accounting pronouncement related to accounting for stock based  
11 compensation.

12 **Q. WHY SHOULD THIS DEFERRED TAX ASSET BE INCLUDED IN RATE BASE?**

13 A. The related deferred tax represents a book deduction for which there has not yet been a tax  
14 deduction. A tax benefit has not yet been received.

15 **Q. WHAT IS THE DEFERRED TAX RELATED TO THE NET OPERATING LOSS**  
16 **DEDUCTION?**

17 A. The deferred tax asset related to the Net Operating Loss Deduction represents the future tax  
18 reduction to be received when the Net Operating Loss is used to offset taxable income.

19 **Q. WHY SHOULD THIS DEFERRED TAX ASSET BE INCLUDED IN RATE BASE?**

20 A. This deferred tax asset ("DTA") represents the amount of tax to be utilized in future periods  
21 to offset future taxable income. A tax benefit has not yet been received. This DTA is  
22 mostly due to "bonus depreciation" which is a deferred tax liability ("DTL") that is being

1           deducted from rate base. It is inappropriate to include the DTL without also including the  
2           resulting DTA related to the net operating loss.

3   **Q. WHAT IS THE ALTERNATIVE MINIMUM TAX?**

4   A. Alternative Minimum Tax (“AMT”) is tax liability required to be paid in addition to regular  
5       income tax liability. It is essentially a required tax prepayment for which a credit is  
6       allowed in future periods.

7   **Q. WHY SHOULD THIS DEFERRED TAX ASSET BE INCLUDED IN RATE BASE?**

8   A. AMT represents a required cash prepayment or additional outlay of capital and should,  
9       therefore, increase rate base.

10 **PROPERTY TAX COST OF SERVICE**

11 **Q. WHAT IS THE ISSUE WITH STAFF’S CALCULATED COST OF SERVICE**  
12 **RELATED TO PROPERTY TAX?**

13 A. Staff has computed a composite property tax rate from a previous period based on plant in  
14       service. In Staff’s recommendation for recovery in this case, Staff applied this rate to plant  
15       in service at December 31, 2014.

16 **Q. WHAT PROBLEM DOES THIS CREATE IN THE RECOVERY OF EMPIRE’S**  
17 **PROPERTY TAX COST OF SERVICE?**

18 A. Applying this rate to plant in service at December 31, 2014, basically provides recovery of  
19       only the 2015 level of property tax expense. Staff’s proposal denies recovery of expense  
20       related to plant acquired in 2015 and 2016, including the additional property tax to be  
21       incurred related to the large new plant addition at Riverton.

22 **Q. HOW CAN THIS TIME LAG IN STAFF’S CALCULATION BE ELIMINATED?**

1 A. Staff should update the effective rate calculation and plant in service balances to March 31,  
2 2016, the true-up date in this case, to eliminate the time lag in Staff's calculation.

3 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**


4 A. Yes it does.



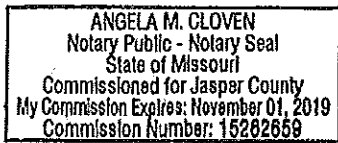
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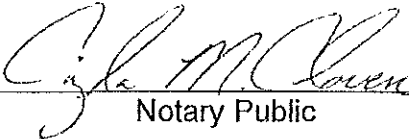
STATE OF MISSOURI    )  
                                  ) ss  
COUNTY OF JASPER    )

On the 25th day of April, 2016, before me appeared L. Jay Williams, to me personally known, who, being by me first duly sworn, states that he is Regulatory Tax Manager of The Empire District Electric Company and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.

  
\_\_\_\_\_  
L. Jay Williams

Subscribed and sworn to before me this 25th day of April, 2016.



  
\_\_\_\_\_  
Notary Public

My commission expires: 11/01/19.