



General Telephone Company  
Of The Midwest

February 27, 1987  
LR 10-12-1

11 Eleventh Ave. - P.O. Box 330  
Grinnell, Iowa 50112

Mr. Harvey G. Hubbs, Secretary  
Missouri Public Service Commission  
Truman State Office Building  
5th Floor, 301 West High Street  
P. O. Box 360  
Jefferson City, Missouri 65102

Dear Mr. Hubbs:

SUBJECT: CASE NO. AO-87-48 - IMPACT OF TAX REFORM ACT OF 1986

As requested in Case No. AO-87-48, issued November 3, 1986, General Telephone Company of the Midwest (General) provides the enclosed updated response quantifying the effects of the Tax Reform Bill of 1986. This is based upon 1986 unadjusted operating results. Please note that the impact of tax reform has also been included in the Staff's rate complaint Case TC-87-57 using adjusted data for a twelve month period ending June 30, 1986. Since this adjusted data incorporates the impact of future changes on General, I believe it is significantly more accurate, and should be used in lieu of the unadjusted data.

General has determined that, based on the adjusted data filed in TC-87-57, the impact of the tax changes does not have a significant impact on the Company's projected intrastate rate of return, which is estimated to be approximately 4.2%. This return includes the effect of major Commission orders in addition to tax reform.

Should you have any questions regarding this submission, please contact Kip Hendrickson, State Director-Regulatory Affairs, at (515) 269-2807.

Sincerely,

*Kip Hendrickson*  
for G. E. ALDRICH, JR.

State Vice President-General Manager

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Enclosure

**FILED**

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PUBLIC SERVICE COMMISSION

COMMENTS OF  
GENERAL TELEPHONE COMPANY OF THE MIDWEST  
CASE NO. AO-87-48

In response to Case No. AO-87-48 relating to the Tax Reform Act of 1986, General Telephone Company of the Midwest submits the following information based on unadjusted 1986 intrastate operating results:

Request 1: Based on the tax law in effect in 1986, calculate a revenue requirement showing the operating results of unadjusted calendar year 1986.

Response 1: As shown on Exhibit 1, page 3 of 3, in the column labeled "Base Case-1986 Tax Law", General's revenue requirement is \$5,552,000 based up on the Commission's surveillance return of 11.2%. These operating results indicate that General's return is 7.35%, which is far below the Commission's surveillance level.

Request 2: Based on the new tax law using the tax rate(s) and other known tax changes applicable to calendar year 1987 taxable income (e.g. a 40% phased tax rate for 1987), calculate a revenue requirement showing the operating results of unadjusted calendar year 1986.

Response 2: As shown on Exhibit 1, page 2 of 3, in the column labeled "1987 Tax Law", the additional intrastate income tax expense because of the 1987 changes applied to 1986 unadjusted operating results is \$39,000. General has an intrastate revenue requirement of \$5.0 million and an estimated rate of return (assuming all other things constant) of 7.33%. The workpapers detailing the change in total income taxes are shown on pages 1 and 2 of Exhibit 1.

Request 3: Based on the new tax law using the tax rate(s) and other known tax changes applicable to tax years subsequent to calendar year 1987, calculate a revenue requirement showing the operating results of unadjusted calendar year 1986.

Response 3: As shown on Exhibit 1, page 2 of 3, in the column labeled "1988 Tax Law", the reduction in intrastate income tax expense because of the 1988 changes applied to 1986 unadjusted results is \$483,000. General continues to have a large intrastate revenue requirement need of over \$3.8 million and an estimated rate of return (assuming all other things constant) of 7.99%. The workpapers detailing the change in total income taxes are shown on pages 1 and 2 of Exhibit 1.

Request 4: Provide the workpapers supporting the amount of excess deferred tax reserves attributable to the turnaround of tax/book timing differences at a tax rate lower than the rate(s) at which the reserve has thus far been established.

COMMENTS OF  
GENERAL TELEPHONE COMPANY OF THE MIDWEST  
CASE NO. AO-87-48

Response 4: These amounts are identified on Exhibit 1, page 1 of 3, as "Reversal of Deferred Taxes Associated with Rate Change". Also a schedule supporting the calculation is included as Exhibit 2.

Request 5: All deferred tax expense and reserve information shall be presented in a fashion which will allow a ready disaggregation between the types of tax/book timing differences which gave rise to the deferred tax expense or reserve (e.g., accelerated depreciation, ITC, Schedule M items normalized, phase-in plans, etc.).

Response 5: These amounts have been identified on Exhibit 1.

Request 6: Please provide further information which the Company deems necessary in examining the revenue requirement impact of the tax law change.

Response 6: The magnitude of the tax impact will vary widely across companies. To presume that the tax change has a direct relationship with authorized earnings would unfairly penalize or reward companies. General believes that the Commission should examine each company individually by comparing the actual earnings level of each to its authorized return level. In addition, General strongly points out that the tax reform impacts included in this package are based upon unadjusted earnings for the twelve months ending December 31, 1986 and the industry environment as it existed during that time. The Tax Reform impacts and base level of earnings ending December 31, 1986 in no way represents General's future earnings and anticipated Tax Reform impacts. There are a myriad of other changes that will be taking place over the next twelve to eighteen months. For example, six months after the new tax rate is fully effective, the revised Uniform System of Accounts (USOA) will be implemented. The revised accounting system generally has the effect of increasing revenue requirement by expensing items that were previously capitalized. Any decrease in tax liability may be useful in meeting the revenue requirement caused by USOA. The Missouri Commission has also issued an order deregulating embedded customer premise equipment (CPE) on December 31, 1987. Therefore, the contribution that CPE has made to local service rates will disappear and this will also increase General's revenue requirement. In addition there are a number of events evolving in the toll/access arena, such as changes in compensation plans and the crucial need to transition nontraffic sensitive costs to the local ratepayer. Also the critical need for additional capital recovery should also be reviewed.

The impact of these events have been specifically quantified in the Missouri Commission Staff's rate complaint case TC-87-57. General

COMMENTS OF  
GENERAL TELEPHONE COMPANY OF THE MIDWEST  
CASE NO. AO-87-48

Response 6: (Cont'd)

has filed testimony in this case indicating that, based upon an adjusted test year ending June 30, 1986, incorporating tax reform and these other very important events, a return of only 4.42% would be earned.

General recognizes that the Commission is concerned that utilities not unfairly benefit by the changed tax laws. However, only by reviewing each company's earnings on a case by case basis and considering the other changes occurring throughout the telecommunication's industry can the Commission make an appropriate evaluation. This method would be equitable to both ratepayers and stockholders.

GENERAL TELEPHONE COMPANY OF THE MIDWEST  
CASE NO. AG-87-48  
TAX REFORM ACT OF 1986  
(000)

TAX REFORM

EFFECT ON MISSOURI INTRASTATE OPERATIONS

|                      | 1984          |        |       | 1987 TAX LAW  |        |       | 1988 TAX LAW  |        |       |
|----------------------|---------------|--------|-------|---------------|--------|-------|---------------|--------|-------|
|                      | INTRASTATE    |        |       | INTRASTATE    |        |       | INTRASTATE    |        |       |
|                      | BOOK<br>TOTAL | PCT    | AMT   | BOOK<br>TOTAL | PCT    | AMT   | BOOK<br>TOTAL | PCT    | AMT   |
| OPER. REV.           | 58950         |        | 41104 | 58950         |        | 41106 | 58950         |        | 41106 |
| OPER. EXP.           | 45844         |        | 33581 | 45844         |        | 33581 | 45844         |        | 33581 |
|                      | 13104         |        | 7525  | 13104         |        | 7525  | 13104         |        | 7525  |
| ADD:                 |               |        |       |               |        |       |               |        |       |
| DEPR ADJ             | 2791          | 70.01% | 1954  | 2791          | 70.01% | 1954  | 2791          | 70.01% | 1954  |
| BAD DEBTS ADJ        | NA            | NA     | NA    | 54            | 70.01% | 38    | 54            | 70.01% | 38    |
| MEALS/ENTERTAINMENT  | NA            | NA     | NA    | 46            | 70.01% | 32    | 46            | 70.01% | 32    |
| INTEREST CAPITALIZED | NA            | NA     | NA    | 267           | 70.01% | 187   | 267           | 70.01% | 187   |
| PROP TAX CAPITALIZED | NA            | NA     | NA    | 144           | 70.01% | 101   | 144           | 70.01% | 101   |
| LESS:                |               |        |       |               |        |       |               |        |       |
| FIXED CHARGES        | -3904         | 70.01% | -2733 | -3904         | 70.01% | -2733 | -3904         | 70.01% | -2733 |
| PENSION COSTS        | -529          | 70.01% | -370  | NA            | NA     | NA    | NA            | NA     | NA    |
| PAYROLL TAXES        | -202          | 70.01% | -141  | NA            | NA     | NA    | NA            | NA     | NA    |
| SALES TAXES          | -273          | 70.01% | -191  | NA            | NA     | NA    | NA            | NA     | NA    |
| EXCESS DEPRECIATION  | -3917         | 70.01% | -2742 | -3917         | 70.01% | -2742 | -3917         | 70.01% | -2742 |
| ADJUSTED INCOME      | 7070          |        | 3301  | 8585          |        | 4361  | 8585          |        | 4361  |

CALCULATION OF CURRENT FEDERAL INCOME TAX

|  |       |        |      |        |        |      |
|--|-------|--------|------|--------|--------|------|
| ADJUSTED INCOME  | 7070  | 3301   | 8585 | 4361   | 8585   | 4361 |
| LESS: STATE TAX  | 195   | 91     | 263  | 134    | 288    | 146  |
| FEDERAL TAXABLE INC  | 6875  | 3209   | 8322 | 4228   | 8297   | 4215 |
| FED RATE   | 46%   | 46%    | 40%  | 40%    | 34%    | 34%  |
| FED TAX  | 3162  | 1476   | 3329 | 1691   | 2821   | 1433 |
| LESS:  |       |        |      |        |        |      |
| ITC AMORTIZATION   | -1267 | 70.01% | -887 | -1267  | 70.01% | -887 |
| TOT FED TAX BEFORE<br>REVERSAL OF EXCESS<br>DEFERRED TAXES | 1895  | 589    | 2042 | 804    | 1534   | 546  |
| REVERSAL OF DEFERRED TAXES<br>ASSOCIATED W/RATE CHANGE     | NA    | NA     | -133 | 70.26% | -93    | -265 |
| TOTAL FIT  | 1895  | 589    | 1929 | 711    | 1289   | 360  |

GENERAL TELEPHONE COMPANY OF THE MIDWEST  
CASE NO. AQ-87-48  
TAX REFORM ACT OF 1986  
(000)

TAX REFORM ----- EFFECT ON MISSOURI INTRASTATE OPERATIONS (CONT.)

CALCULATION OF CURRENT STATE INCOME TAX

|                          | 1986 TAX LAW  |     |      | 1987 TAX LAW  |     |      | 1988 TAX LAW  |     |      |
|--------------------------|---------------|-----|------|---------------|-----|------|---------------|-----|------|
|                          | INTRASTATE    |     |      | INTRASTATE    |     |      | INTRASTATE    |     |      |
|                          | BOOK<br>TOTAL | PCT | AMT  | BOOK<br>TOTAL | PCT | AMT  | BOOK<br>TOTAL | PCT | AMT  |
| ADJUSTED INCOME          | 7070          |     | 3301 | 8585          |     | 4361 | 8585          |     | 4361 |
| LESS:                    |               |     |      |               |     |      |               |     |      |
| FEDERAL TAX              | 3162          |     | 1476 | 3329          |     | 1691 | 2821          |     | 1433 |
| NET OF FED               | 3908          |     | 1824 | 5256          |     | 2670 | 5764          |     | 2928 |
| STATE SIT RATE           | 0.05          |     | 0.05 | 0.05          |     | 0.05 | 0.05          |     | 0.05 |
| CURRENT STATE INCOME TAX | 195           |     | 91   | 263           |     | 134  | 288           |     | 146  |
| TOTAL CURRENT INCOME TAX | 2091          |     | 680  | 2192          |     | 844  | 1577          |     | 506  |

CALCULATION OF DEFERRED INCOME TAX

|   |                |        |      |                |        |      |                |        |      |
|---|----------------|--------|------|----------------|--------|------|----------------|--------|------|
| EXCESS DEPRECIATION<br>RATE                                       | 3917<br>0.4749 |        |      | 3917<br>0.4184 |        |      | 3917<br>0.3622 |        |      |
|   | 1860           | 70.01% | 1302 | 1639           | 70.01% | 1147 | 1419           | 70.01% | 993  |
| TOTAL INCOME TAX  | 3951           |        | 1983 | 3831           |        | 1992 | 2996           |        | 1499 |
| INCREASE (DECREASE)<br>IN TOTAL INCOME TAXES<br>DUE TO TAX REFORM |                |        |      | -120           |        | 9    | -955           |        | -483 |

GENERAL TELEPHONE COMPANY OF THE MIDWEST

MISSOURI CASE NO. AO-87-48  
TAX REFORM ACT OF 1986

INTRASTATE REVENUE REQUIREMENT  
(DOLLARS IN THOUSANDS)

|   | <u>Base Case<br/>(1986 Tax Law)</u> | <u>1987 Tax Law</u> | <u>1988 Tax Law</u> |
|---|-------------------------------------|---------------------|---------------------|
| Rate Base   | \$75439                             | \$75439             | \$75439             |
| Rate of Return  | <u>11.20%</u>                       | <u>11.20%</u>       | <u>11.20%</u>       |
| Return  | 8449                                | 8449                | 8449                |
| Adjusted Net Income   | <u>5542</u>                         | <u>5533</u>         | <u>6026</u>         |
| Income Deficit  | 2907                                | 2916                | 2423                |
| Gross Up Factor   | 1.91                                | 1.72                | 1.57                |
| Add'l Revenue Requirement   | \$ 5552                             | \$ 5016             | \$ 3804             |
| Increase/(Decrease) in<br>Total Revenue Requirement<br>Due to Tax Reform: |                                     |                     |                     |
| Income Tax Expense  |                                     | 16                  | <759>               |
| Gross Up Factor   |                                     | <552>               | <989>               |
| Earned Rate of Return   | 7.35%                               | 7.33%               | 7.99%               |

MISSOURI  
CASE NO. 40-87-48  
EFFECTS OF TAX REFORM  
(000)

REVERSAL OF DEFERRED TAXES ATTRIBUTABLE TO THE TURNAROUND OF TAX/BOOK  
TIMING DIFFERENCES AT RATES LOWER THAN THE RATE AT WHICH THE RESERVE HAS  
THUS FAR BEEN ESTABLISHED.

TO DETERMINE THE AMOUNT OF REVERSAL, A STUDY WAS MADE OF THE REVERSALS  
WHICH OCCURRED IN THE 1985 TAX YEAR. THIS IS THE MOST RECENT YEAR THAT  
ACTUAL INFORMATION IS AVAILABLE.

AMOUNT OF THE REVERSAL IN 1985 IN  
EXCESS OF THE 34% RATE

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AMOUNT OF THIS REVERSAL ATTRIBUTABLE  
TO A RATE IN EXCESS OF THE CURRENT 46%  
RATE. (THIS AMOUNT IS NOT ATTRIBUTABLE  
TO THE TAX REFORM ACT.)

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AMOUNT IN 1985 ATTRIBUTABLE TO THE  
RATE CHANGE FROM 46% TO 34% OUTLINED  
IN THE TAX REFORM ACT.

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ONE-HALF EFFECT FOR 1987, WHERE RATE  
IS 40%

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