

**TENNESSEE-AMERICAN WATER COMPANY, INC.**

**DOCKET NO. 18-00022**

**REBUTTAL TESTIMONY**

**OF**

**JOHN R. WILDE**

**ON**

**CHANGES TO THE QUALIFIED INFRASTRUCTURE INVESTMENT PROGRAM  
RIDER, THE ECONOMIC DEVELOPMENT INVESTMENT RIDER, AND THE  
SAFETY AND ENVIRONMENTAL COMPLIANCE RIDER**

1 **Q. PLEASE STATE YOUR NAME.**

2 A. My name is John R. Wilde.

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

4 A. I am employed by American Water Works Service Company, Inc. (“Service Company”)  
5 as Vice President, Tax Strategy and Compliance. The Service Company is a subsidiary of  
6 American Water Works Company, Inc. (“American Water”) that provides services to  
7 American Water’s subsidiaries, including Tennessee-American Water Company  
8 (“Tennessee-American,” “TAWC” or the “Company”).

9 **Q. PLEASE OUTLINE YOUR EDUCATIONAL BACKGROUND AND BUSINESS**  
10 **EXPERIENCE.**

11 A. I graduated from Saint Norbert College, De Pere, Wisconsin in 1984 with a Bachelor of  
12 Business Administration Degree in Accounting. I have a graduate certificate in state and  
13 local taxation, as well as a Master of Science Degree in Taxation from the University of  
14 Wisconsin-Milwaukee. I have over 30 years of experience as a tax and accounting  
15 professional serving utilities with regulated operations in multiple states. Before coming  
16 to American Water, I spent fifteen years as the head of tax for a corporate group (WEC  
17 Energy Group, Inc., formerly Integrys Energy Group, Inc.) that had six utilities with  
18 operations in four states.

19 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION OR ANY**  
20 **OTHER REGULATORY AGENCIES?**

21 A. Yes. I have testified before the Federal Energy Regulatory Commission, the Public Service  
22 Commission of Wisconsin, the Michigan Public Service Commission, the Virginia State  
23 Corporation Commission, the Illinois Commerce Commission, the Kentucky Public

1 Service Commission, the Minnesota Public Utilities Commission, Virginia State  
2 Corporation Commission, Missouri Public Service Commission, the California Public  
3 Utilities Commission, the West Virginia Public Service Commission, and the Pennsylvania  
4 Public Utility Commission.

5 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

6 A. The purpose of my Rebuttal Testimony is to respond to the Pre-filed Testimony of David  
7 N. Dittemore, witness for the Consumer Protection and Advocate Division of the  
8 Tennessee Attorney General's Office ("CPAD"), filed with the Tennessee Public Utility  
9 Commission ("TPUC" or "Commission") on July 6, 2018.

10 **Q. WHAT IS THE RECOMMENDATION MADE BY MR. DITTEMORE IN HIS**  
11 **TESTIMONY THAT YOU WILL BE REBUTTING?**

12 A. Mr. Dittemore recommends reducing the Capital Rider reconciliation by \$812,028, to  
13 reflect additional Accumulated Deferred Income Taxes in the amount of \$8,931,682, that  
14 he attributes to claiming bonus and tax repair deduction on capital rider property.<sup>1</sup> He  
15 derives this result by including Bonus and Repairs deductions into the rider reconciliation  
16 calculation, without then addressing TAWC Net Operating Loss ("NOL") carryover  
17 position.<sup>2</sup>

18 **Q. WHAT ARE BONUS AND REPAIR DEDUCTIONS?**

19 A. For income tax purposes there are complex rules regarding Bonus Depreciation and Repair  
20 Deductions. If property qualifies for bonus depreciation, additional first year depreciation  
21 is allowed, but the bonus depreciation claimed then reduces tax basis on the property that  
22 will be eligible for MACRS depreciation deductions. For the duration of the Capital Rider

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<sup>1</sup> Exhibit DND-2, line 4.

<sup>2</sup> Exhibit DND-3

1 (2014-2017), the amount of the additional 1<sup>st</sup> year deduction is 50% of the qualifying asset  
2 basis. The asset basis is then reduced by the amount of this deduction. MACRS  
3 depreciation is taken on the remaining asset basis balance.

4 The repairs deduction is far more complex. Unlike regulatory and financial accounting,  
5 income tax rules generally allow more costs incurred related to property plant and  
6 equipment to be considered routine repair and maintenance costs. Internal Revenue Code  
7 (“IRC”) section 263(a) states that “No deduction shall be allowed for—Any amount paid  
8 out for new buildings or for permanent improvements or betterments made to increase the  
9 value of any property or estate.” Instead, these amounts are capitalized. Deductions for  
10 these amounts against taxable income occur generally through depreciation or amortization  
11 of the capitalized amount if applicable, or as basis which reduces gains or creates losses on  
12 the sale or abandonment of the asset. The IRC sections 263(a) wording of “permanent  
13 improvements or betterments made to increase the value of any property” have been the  
14 subject of controversy for many years, resulting in a body of law determined by the courts.  
15 In an attempt to eliminate the controversy and sometimes seemingly inconsistent treatment  
16 of taxpayers, Treasury issued regulations commonly referred to as the “Repairs  
17 Regulations”. The repair regulations were generally consistent with the companies repairs  
18 deductions that were taken after it changed its method in 2008. These rules require a  
19 detailed analysis of the facts and circumstances of each project. The facts and  
20 circumstances are then analyzed in the context of what the regulations refer to as a unit of  
21 property. If the expenditure results in the betterment of the unit of property, the restoration  
22 of the unit of property, or adapts the unit of property to a new or different use, the amount  
23 is capitalized. If it does not, the amount is deducted as a repair.

1 **Q. ARE BONUS AND REPAIRS DEDUCTIONS CONSISTENT, PREDICTABLE,**  
2 **AND EASY TO CALCULATE?**

3 A. While the rules around qualification of property for bonus depreciation can in some cases  
4 be complex, the computations are generally straight forward. The tax law around bonus  
5 depreciation has been inconsistent and unpredictable over the years, though. It was first  
6 enacted in 2001 and continued through 2004. Then it was re-enacted in 2008 and has been  
7 available ever since, though now with the signing of the TCJA at the end of 2017, bonus  
8 depreciation ended for public utility companies after 09/27/17 and they can no longer take  
9 bonus depreciation on new additions. While bonus depreciation has been around for a long  
10 time, there were always set end dates in the tax law for the deduction to go away and it was  
11 continually re-enacted for a short period of time, often either at the end of the tax year or  
12 retroactively. Over the years the percentage also changed though it was mostly 50%. At  
13 times companies did not know if bonus depreciation would be extended or not and could  
14 not include bonus depreciation in any filings or projections unless known.

15 Repairs, as discussed above, is much more complex and much more facts and circumstance  
16 based. In order to produce the repairs deduction the company has had to hire a national  
17 accounting firm ever since 2008. While early proposed regulations could be adopted  
18 starting in 2008, which the company did, the final regulations were signed in 2013,  
19 effective for 2014 and after, yet there is still uncertainty with how to apply the law,  
20 especially for the Water industry and regarding network property. While the IRS issued  
21 industry guidance for the electrics and telephone industries, there is no plan to issue one  
22 for the water industry. In addition, the deductions taken by the company have not been  
23 audited by the IRS. These uncertainties create complexities. In the context of a forecast or

1 isolated property, the best that can be done is to use historical percentages tracked over the  
2 last 10 years to estimate a repairs deduction. It should be noted that the annual repair  
3 percentage can vary from year to year depending on the amount expended on replacement  
4 property each year and what type of property was replaced.

5 **Q. ARE THE DEFERRED INCOME TAXES IN THIS FILING SUBJECT TO IRS**  
6 **NORMALIZATION RULES?**

7 **A.** Deferred Income taxes resulting from accelerated depreciation and bonus depreciation are  
8 subject to the tax normalization rules.

9 **Q. WHAT ARE THE TAX NORMALIZATION RULES?**

10 **A.** In short, Public Utility Property is allowed accelerated depreciation and bonus depreciation  
11 only if a normalization method of accounting is applied in the regulatory books of the  
12 utility.

13 **Q. IF NORMALIZATION IS FOLLOWED AND INCOME TAX EXPENSE**  
14 **INCLUDES DEFERRED TAXES, HOW ARE CUSTOMERS COMPENSATED**  
15 **FOR THE REDUCTION IN TAX PAYMENTS THAT HAPPENS WHEN**  
16 **ACCELERATED DEPRECIATION AND BONUS DEPRECIATION ARE**  
17 **CLAIMED?**

18 **A.** Income taxes that result from using a normalization method of accounting are included as  
19 a reduction to rate base.

20 **Q. WHAT HAPPENS IF THE DEDUCTIONS FOR BONUS DEPRECIATION AND**  
21 **REPAIRS ARE SO GREAT THE COMPANY INCURS A LOSS?**

1 A. When a company incurs a net operating loss, it is allowed to carry that loss forward. In  
2 that case, the company records a deferred tax asset representing the future value of the  
3 usage of that loss.

4 **Q. HOW DOES THE NOL DEFERRED TAX ASSET RELATE TO THE DEFERRED**  
5 **TAX LIABILITIES GENERATED BY THE ACCELERATED DEPRECIATION,**  
6 **BONUS DEPRECIATION AND REPAIRS?**

7 A. The deferred tax asset economically represents an offset to the deferred income tax  
8 liabilities. In other words, it is implied that the company received zero cost capital from  
9 the government equal to the deferred income tax liability. However, the presence of a Net  
10 Operating Loss carryover position is indicative of the Company not yet having received  
11 the cash balance of deductions generated. The amount of zero cost capital not received by  
12 the company is equal to the amount of the NOL deferred tax asset.

13 **Q. WHY IS IT NECESSARY TO PERFORM AN NOL TEST IF BONUS AND**  
14 **REPAIRS DEDUCTIONS ARE INCLUDED IN THE CALCULATION?**

15 A. Obviously it would be economically incorrect to include a deferred income tax liability as  
16 a reduction to rate base if the company did not indeed achieve the full amount of cash from  
17 tax deductions claimed. It simply is incorrect and unfair to reduce rate base by more than  
18 what actually occurred. In addition the income tax normalization rules as a matter of  
19 consistency require that the rate base reduction for deferred taxes be reduced by the  
20 amounts of the NOL deferred tax asset that exists using a with and without test. In this  
21 case all of the NOL deferred income tax asset was caused by the company's repair  
22 deduction and accelerated depreciation. To not reduce ADIT liabilities by the ADIT asset  
23 is both incorrect and unfair as well as a normalization violation.

1 **Q. WHAT IS A NORMALIZATION VIOLATION AND WHAT ARE ITS IMPACTS?**

2 A. The company would lose the ability to claim accelerated depreciation on its public utility  
3 property permanently increasing rate base to the detriment of rate payers.

4 **Q. CAN YOU PROVIDE AN NOL CALCULATION THAT SHOULD BE USED IF**  
5 **THE REPAIRS AND BONUS DEDUCTIONS WERE TO BE INCLUDED IN THE**  
6 **RIDER MECHANISM RECONCILIATION?**

7 A. The Company's response to the CAPD's third discovery request, Item 10, Attachment 1 in  
8 this docket, provides an NOL calculation. It shows the Deferred Tax Liabilities and  
9 Deferred Tax Assets (NOL) associated with the Capital Riders, including bonus and  
10 repairs, as well as the Net ADIT Liability. A summary of the figures from this schedule  
11 are shown below in Table JRW-1, along with a calculation of the average net ADIT liability  
12 for 2017. Including bonus and repairs, the figure is approximately \$1.3 million. This is  
13 significantly lower than the \$8.9 million ADIT balance proposed by Mr. Dittmore on  
14 Exhibit DND-2.

15 **Table JRW-1**

			2014	2015	2016	2017
<b>Balance Sheet:</b>						
Deferred Tax Liability (credit balance)			(1,534,790)	(5,946,714)	(9,224,686)	(13,694,209)
Deferred Tax Asset			1,485,222	5,702,762	8,407,030	12,003,513
<b>Net Liability (liab = credit balance)</b>			<b>(49,568)</b>	<b>(243,953)</b>	<b>(817,656)</b>	<b>(1,690,696)</b>
<b>Average Net ADIT Liability for 2017, including Bonus and Repairs</b>						<b>(1,254,176)</b>

16  
17 **Q. WHY DOESN'T THE CPAD SUPPORT RECOGNIZING THE NOL?**

18 A. The CPAD doesn't support recognizing the NOL for two reasons:



1 1) CPAD claims that TAWC's NOL is hypothetical, because TAWC had taxable income  
2 as an overall Company when you sum years 2014-2017<sup>3</sup>

3 2) The CAPD claims the Private Letter Rulings (PLRs) submitted by the Company are  
4 not relevant to the issue identified in this case.<sup>4</sup>

5 **Q. IS THE CPAD'S CLAIM REASONABLE, THAT TAWCS NOL IS**  
6 **HYPOTHETICAL, BECAUSE TAWC HAD TAXABLE INCOME, IN SUM,**  
7 **FROM YEARS 2014 – 2017?**

8 A. No, it is not reasonable. TAWC is carrying forward an NOL generated from taking  
9 accelerated tax depreciation, bonus depreciation and a repairs deductions going back to  
10 2008, and TAWC would have been in a NOL carryforward position as of 12/31/2013.  
11 See JRW\_RT\_Attachment 1 to see TAWC's taxable income or loss since 2008. As  
12 demonstrated in Attachment 1 of TAWC's response to the Item 10 of the CPAD's Third  
13 Discovery Request in this docket, the 2014-2017 Capital Rider inclusive of bonus  
14 depreciation and tax repairs would incrementally produces additional net operating losses  
15 for the 2014-2017. Rulings by the IRS support the companies approach in treating the  
16 calculation for a rate mechanism like a Capital Rider as being separate form and  
17 incremental base rates. While we would agree that if there truly was no NOL  
18 carryforward on a consolidated basis or on a standalone basis, simply having an isolated  
19 NOL in this recovery mechanism would not require a DTA related to the NOL  
20 carryforward. However, that is not what has happened. We do have a consolidated NOL  
21 carryforward, and TAWC has had net cumulative losses since 2008, and therefore has

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<sup>3</sup> Dittmore Direct Testimony, p. 12, lines 19-22, and page 13, lines 1-4

<sup>4</sup> Dittmore Direct Testimony, p. 13, lines 8-9

1 Net operating loss DTA. The DTA exists during all relevant periods. To determine  
2 how the specific recovery mechanism affects the NOL we have no choice but to look  
3 solely at the data contained in this mechanism. To ignore the existence of the NOL  
4 carryforward during the relevant time period is inappropriate

5 **Q. IS THE CAPD'S CLAIMS REASONABLE, THAT THE PRIVATE LETTER**  
6 **RULINGS, PROVIDED BY TAWC IN RESPONSE TO DISCOVERY REQUESTS**  
7 **FROM THE CPAD, DON'T APPLY TO THE FACTS OF THIS CASE?**

8 A. While PLR's are specific to the facts described in the PLR and there is a statement  
9 at the end that states "This ruling is directed only to the taxpayer who requested it.", it does  
10 explain the law and as a general practice can be used by other taxpayers when the law is  
11 clear. In this case, the PLR's provided basically state that it is a normalization violation to  
12 exclude from rate base, NOL's related to accelerated tax depreciation, for which bonus  
13 depreciation is included.

14 **Q. WHAT DO YOU RECOMMEND RELATED TO THE CALCULATION OF ADIT**  
15 **IN THIS CASE?**

16 A. Ms. Bridwell's testimony addresses TAWC's position as to why Bonus and Repairs  
17 deductions should not be included in the Capital Recovery Riders calculations. I  
18 recommend that if the TPUC directs Bonus and Repairs deductions to be included in the  
19 calculation of the 2017 Capital Rider Reconciliation, that the associated NOL also be  
20 included, as shown on Attachment 1 of TAWC's response to Item 10 of the CPAD's third  
21 discovery request in this docket, and in the schedule above, in order to avoid a  
22 normalization violation and the loss of accelerated depreciation deductions for Tennessee  
23 American Water.

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

2             Yes.

Tennessee-American Water Company  
Docket No 18-00022  
Rebuttal Testimony of John R Wilde

Tax Year	Taxable Income (Loss)	NOL CF
2008	(9,304,479)	
2009	(401,798)	
2010	(2,787,041)	
2011	3,102,811	
2012	(6,328)	
2013	7,440,573	
Subtotal at 12/31/2013	<u>(1,956,262)</u>	<u>(4,648,513)</u>
2014	(3,034,255)	
2015	(2,459,715)	
2016	4,711,448	
2017	2,235,988	
Subtotal at 12/31/2017	<u>(502,796)</u>	<u>(4,938,170)</u>

Note that 2017 Taxable Income (Loss) is the provision estimate and not from the tax return, as it is not filed at the time of this being submitted.