BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 080317-EI

IN RE: TAMPA ELECTRIC COMPANY'S
PETITION FOR AN INCREASE IN BASE RATES
AND MISCELLANEOUS SERVICE CHARGES

DIRECT TESTIMONY AND EXHIBIT
OF
ALAN D. FELSENTHAL
ON BEHALF OF TAMPA ELECTRIC COMPANY

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

PREPARED DIRECT TESTIMONY

OF

ALAN D. FELSENTHAL

ON BEHALF OF TAMPA ELECTRIC COMPANY

Q. Please state your name, business address, occupation and employer.

A. My name is Alan D. Felsenthal. My business address is 550 West Van Buren Street, Chicago, Illinois 60607. I am employed by Huron Consulting Group ("Huron").

Q. Please provide a brief outline of your educational background and business experience.

A. Upon graduating from the University of Illinois in 1971, I was hired by Arthur Andersen & Co. ("Arthur Andersen" or "the Firm"), where I was an auditor, focusing on audits of financial statements of rate regulated entities. I supervised audits, from which the Firm issued audit reports on financial statements that were filed with the Securities and Exchange Commission, Federal Communications Commission, Federal Energy Regulatory Commission ("FERC") and various state commissions.

Arthur Andersen also consulted in a significant number of utility rate cases, and I helped develop testimony for myself and others on a variety of issues including Construction Work in Progress in rate base, phase-in plans, projected test years, lead-lag studies, cost allocation and income tax normalization. I joined PricewaterhouseCoopers ("PwC") in 2002 and continued performing audits and rate work for regulated entities. The testimony was filed in Arizona, Illinois, Indiana, Florida, Michigan, Minnesota, New Mexico, Texas, Nevada and Wisconsin.

I have testified before the Florida Public Service Commission ("FPSC" or "Commission"), the Arizona Corporation Commission and the Illinois Commerce Commission.

Q. Have you dealt with the unique accounting, tax and financial reporting issues encountered by rate regulated enterprises?

A. Yes. Throughout my career, I have focused on utility accounting, income tax and regulatory issues, primarily as a result of auditing regulated enterprises. The unique accounting standards applicable to rate regulated entities are embodied in Financial Accounting Standards Board Statement of Financial Standards ("FAS") 71, FAS 90, FAS 92, FAS 101, FAS 109 and various Emerging Issues Task Force issues. These standards must be understood so that auditors can determine if the standards have been applied appropriately. These standards were issued during my career and I have consulted with utilities as to how they should be applied. At both Arthur Andersen and PwC, I worked with the technical industry accounting and auditing leadership to communicate and consult on utility accounting and audit and income tax matters.

Q. What are your current responsibilities?

A. I am a managing director at Huron. Huron provides a variety of accounting, tax and consulting services to various industry sectors. My focus is on the regulated industry sector, primarily electric and gas utilities.

Q. Have you provided training on the application of Generally Accepted Accounting Principles ("GAAP") to rate regulated enterprises?

A. Yes. At Arthur Andersen, PwC and Huron, I have developed and presented utility accounting seminars focusing on the unique aspects of the regulatory process and the resulting accounting consequences of the process on the application of GAAP. One of the seminars I have presented focuses on the unique accounting and ratemaking impacts applicable to income tax accounting for rate regulated enterprises, including the specific requirements of the Internal Revenue Code ("IRC") applicable to public utilities.

I have presented seminars on an open registration basis as well as delivered training on an in-house basis. Seminar participants have included utility company and regulatory commission staff accountants, utility rate departments and internal auditors, tax accountants and others. I also conducted these seminars on an in-house basis for the FERC and several state commissions and have presented at various Edison Electric Institute and American Gas Association ratemaking and accounting seminars. Personnel from various state regulatory commissions have attended the open registration sessions.

TESTIMONY PURPOSE

Q. What is the purpose of your direct testimony?

A. My direct testimony will address several aspects of the income tax calculations submitted by Tampa Electric Company ("Tampa Electric" or "company") in this proceeding.

I will testify on the computation of income tax expense, accumulated deferred income taxes ("ADIT") and unamortized investment tax credit ("ITC") set forth in the company's Minimum Filing Requirement ("MFR") schedules. My testimony will address whether such computations for 2007 are in conformity with GAAP, the Uniform System of Accounts and the requirements of the IRC and Income Tax Regulations.

I will also testify on the calculation of income tax expense, ADIT and unamortized ITC included in the MFRs for the projected year 2009, the test year for this proceeding. My testimony on the 2009 projected information will explain that the projected income tax expense, ADIT and unamortized ITC have been determined using a methodology consistent with the actual 2007 income tax calculations, the projected test year cost of service and the specific IRC and Income Tax Regulations covering projected test years.

Q. What principles guide your direct testimony?

A. My direct testimony is guided by the recognition that in the ordinary operation of a public utility such as Tampa Electric, both the accrual of revenue based on delivery of electric service and the accrual of expenses generate income tax consequences. To the extent that those revenues and expenses are included in the cost of service of the utility, so should the related income tax expense. To do otherwise would deny Tampa Electric the opportunity to recover a necessary cost of providing service. The amount of income tax expense should be consistent with the requirements of GAAP and the IRC.

Q. Have you prepared an exhibit to support your testimony?

A. Yes, I am sponsoring Exhibit No. ____ (ADF-1), entitled "Exhibit of Alan D. Felsenthal, on Behalf of Tampa Electric Company", was prepared under my direction and supervision. This Exhibit consists of:

Document No. 1 List Of Minimum Filing Requirement Schedules Sponsored Or Co-Sponsored By Alan D. Felsenthal

Document No. 2 Calculation Of IRC Required Deferred Income Tax Adjustment

ACCOUNTING FOR INCOME TAXES

Q. Can you please describe the computation of income tax expense?

A. Yes. FAS 109, Accounting for Income Taxes, provides guidance on accounting for income taxes and has been adopted by the FPSC for regulatory purposes in Rule 25-14.013, Florida Administrative Code. There are several components to the calculation. The first component is "current" income tax expense, representing the estimated amount of current year income taxes payable based on current year taxable income. Taxable income for the year is determined in accordance with the IRC. The IRC contains procedures for determining if and when an item is "taxable" or "deductible." The IRC rules for determining what is taxable or deductible may differ from what is reportable as "revenue" or "expense" under GAAP. For instance, certain expenses recorded on the financial statements under GAAP in one year may be deductible on the tax return in a different period. There are also instances where the amounts shown as deductions on the tax return in one year are not reflected on the financial statements until a later year. Differences between the book treatment and the tax return treatment of revenues and expenses result in different balances of book and tax assets and liabilities on the respective book and tax balance sheets. These differences are referred to as temporary differences.

Q. Can you provide an example of a book/tax temporary difference?

A. Yes. When a company acquires a fixed asset, that asset is depreciated for book purposes over its estimated useful life in a systematic and rational manner. Most utilities use the straight-line depreciation method to determine book depreciation expense. For income tax purposes, that same asset may be depreciated for determining taxable income on the income tax return using an accelerated method permitted under the IRC. When the annual depreciation charge for book and income tax purposes is compared each year, there will likely be differences between annual book and tax depreciation. However, given the same capitalized asset cost, total depreciation will be the same over the life of the asset.

Another example of a temporary book/tax difference is the accrual recorded on the books for other post-employment benefit costs, which is not deductible for income tax return purposes until it is settled. In this example, the book accrual/expense occurs in advance of the tax deduction.

A third example is contributions in aid of construction, which are generally considered taxable when received for income tax purposes. However, for book purposes they are recorded as a reduction of property, plant and equipment.

Q. How are differences between the book treatment and income tax treatment of these types of transactions accounted for under FAS 109?

A. In addition to the calculation of current tax expense, FAS 109 requires a calculation of the tax expense on temporary differences. The income tax component resulting from applying the income tax rate to temporary differences at each balance sheet date is known as ADIT. Deferred tax expense reflects the period to period change in ADIT. Because the financial statements reflect accrual accounting, the income tax expense calculation must reflect the liability for income taxes payable in the future as a result of transactions recorded in the current financial statements. Thus, income tax expense under GAAP includes both a currently payable component as well as a deferred income tax component. In the regulated environment, the process of recording deferred income taxes on temporary differences is often referred to as "comprehensive interperiod income tax allocation" or "normalization".

Q. Does the ADIT balance represent an obligation for future income taxes at the balance sheet date?

A. Yes. The ADIT balance at any point in time represents taxes that are expected to be paid in the future based on transactions recorded in the financial statements today. The purpose of deferred income tax accounting is to reflect in the financial statements the tax effects (both current and deferred) of assets, liabilities, revenues and expenses recorded on the financial statements.

ADIT balances are sometimes referred to as an "interest free loan" from the U.S. Treasury. This was the result intended by Congress when it changed the IRC to permit the use of accelerated depreciation. Congress felt that by being allowed to accelerate depreciation deductions (and thereby reduce current income tax payments), companies would lower the financing costs of their investment in capital assets and thus would be incented to incur such expenditures. For accounting purposes, using up the tax basis of capital assets is both a cost to be recognized in the financial statements when claimed (deferred tax expense) and a liability for future taxes due when the turnaround occurs and book depreciation exceeds tax depreciation (ADIT).

Q. Are all book/tax differences "temporary differences"?

A. No. Certain items of revenue and expense are treated differently for financial reporting purposes than for income tax purposes. These are referred to as permanent differences.

An example of a permanent difference is the cost of meals and entertainment, which are reported as expenses in the financial statements but, based on the IRC, are not completely deductible in determining taxable income on the income tax return.

Q. Is the distinction between permanent and temporary differences important in the income tax calculation?

A. Yes. Deferred income taxes are not applicable to permanent differences, because such differences will never be included on income tax returns.

RATEMAKING TREATMENT OF INCOME TAXES

Q. Is deferred income tax accounting appropriate for ratemaking purposes?

A. Yes. Income tax expense in a given year is the result of that year's economic activity. In determining the revenue requirement, it is important for regulatory commissions to consider the recovery of all appropriate costs of providing service, including the associated income tax effects of the costs.

During the ratemaking process, the regulator considers all items of revenues and expenses and makes a finding as to whether the individual revenues and expenses should be allowed in the determination of revenue requirements. Once the regulator determines the allowable costs excluding income taxes, the income tax consequences, both current and deferred, can be calculated. This is because income taxes have no independent existence of their own. They result from an independent determination of revenues and expenses. The revenues and expenses are generally determined on an accrual basis and the tax consequences of revenues and expenses must be determined on that same accrual basis (current and deferred income taxes).

As I discussed earlier, the accelerated depreciation (the major component of deferred taxes for capital intensive entities such as Tampa Electric) of assets was meant to lower the cost of financing assets by providing the company an interest free loan. The ADIT balance (the interest free loan from the U.S. Treasury) is a zero cost source of capital in the cost of capital computation thereby giving the benefit of the reduced financing costs to ratepayers.

Q. Is there another methodology used to compute income tax expense for utilities?

A. Yes. Some regulatory commissions have utilized a "flow-through" methodology. This methodology is not GAAP for enterprises in general. Under flow-through, the tax reducing effects of book/tax temporary differences are flowed-through to ratepayers by only permitting the utility to recover current income tax expense in the cost of service. The deferred income tax expense is not included as a recoverable test year expense. Under flow-through, the "interest free loan" from the U.S. Treasury is not retained by the company to pay the taxes in the future when they become payable. Instead, these interest free funds go to the ratepayers when the temporary difference arises and are paid back by the ratepayer when the taxes become payable.

Because temporary differences, by definition, will reverse in the future, under a flow-through methodology ratepayers receive the benefit of accelerated deductions in the periods where current income tax expense is reduced for such deductions but pay the higher current income tax expense when the temporary difference reverses. No deferred income tax expense is recorded.

Mechanically, a temporary difference that is flowed-through has the same effect as a permanent difference in that no deferred income tax expense is recorded on the flow-through temporary difference. Utility companies whose regulators have determined income tax expense using the flow-through methodology are the only entities that can use this approach for determining income tax expense.

Q. Is flow-through an appropriate methodology?

A. No. The flow-through method has a number of flaws including:

- The stimulus incentives of accelerated income tax deductions are not available to the utility as such benefits are given to ratepayers when the temporary difference arises via a reduction in income tax expense.
- There is a significant potential for intergenerational inequity. Ratepayers who are customers of the company when the flowed-through temporary differences arise will receive the lower income tax expense and may not be the same ratepayers that will be responsible for the higher income tax expense deemed necessary to pay the higher income tax expense when the temporary differences reverse.
- The FERC and others have demonstrated that in the long-term, ratepayers are better off with permitting recovery of deferred income tax expense. This is mainly due to the increased risk associated

with the flow-through methodology, among which is the need for additional rate cases to get back the interest free loan that is in the hands of the ratepayer to be able to pay the increased taxes when the temporary difference reverses.

Q. Has the FERC taken a position on the appropriateness of deferred income tax accounting?

A. Yes. The FERC concluded in Orders 144 and 144A that deferred tax accounting was appropriate. The FERC has required deferred tax accounting since the issuance of those orders in the 1980's.

Q. Has the FPSC taken a position on the appropriateness of deferred income tax accounting?

A. Yes. The FPSC has long acknowledged that normalization is appropriate for revenues and expenses that are recognized at different times for book and tax purposes.

Q. Does the IRC contain requirements addressing deferred income tax accounting?

A. Yes. The IRC contains specific requirements that are applicable to public utility property. These requirements, in effect, mandate that in order for a public utility to be eligible to claim accelerated depreciation for income tax purposes, the regulator must permit recovery of deferred income taxes on the difference resulting from using accelerated depreciation for income tax purposes and straight-line depreciation for book purposes. In other words, the use of the flow-through accounting method for the book/tax depreciation difference would cause a "normalization violation".

The penalty for violating the normalization requirements is the loss of the ability to claim accelerated depreciation for income tax purposes on all assets as of the violation date and on subsequent additions. It is a severe penalty.

Q. Is there another component of the income tax calculation?

A. Yes. In addition to current and deferred income taxes, a third element of the tax computation is the ITC.

Q. Can you please summarize what the ITC is and how it is treated for accounting/rate making purposes?

A. The ITC has gone in and out of existence over the years and lowers income tax expense permanently if certain qualifying investments are made. The intent of the ITC is to reduce the net cost of acquiring depreciable property, thereby providing taxpayers an incentive to invest in qualifying assets. To make sure that its objectives are met for investments in qualifying utility property, the IRC prescribes methods of sharing the benefit between the ratepayers and the shareholders.

The ITC is a direct reduction of income taxes payable in a given year. Unlike accelerated depreciation and other book/tax differences that will eventually reverse or turn around, the ITC is similar to a grant or rebate. The ITC provides an incentive to make capital investments by granting a tax credit (a direct dollar for dollar offset to current taxes payable) based on a percentage applied to investment in tangible personal property (most generation, transmission and distribution assets).

The accounting rules for the ITC are contained in Accounting Principles Board Opinions 2 and 4, <u>Accounting for the Investment Credit</u>. Most utilities account for the ITC by reducing current income taxes for the amount of the ITC realized in a particular year, with an offsetting "unamortized ITC". The unamortized amount is then amortized to reduce income tax expense over the life of the property, giving rise to the ITC. Under this approach, the ITC is reflected in net income over the productive life of the acquired property.

For ratemaking purposes, in 1972 utilities were required to elect how they intended to share the ITC between ratepayers and shareholders. Most utilities, including Tampa Electric, elected to share the ITC by including the annual amortization to income tax expense as an above the line reduction which reduced income tax expense benefiting ratepayers. The unamortized amounts were not used to reduce rate base, benefiting shareholders who were entitled to earn on property, plant and equipment financed partially by the ITC "grant" or "rebate".

The ITC was repealed as a result of the Tax Reform Act of 1986. Tampa Electric had realized ITC on tax returns prior to its repeal and the current filing reflects unamortized ITC on property, plant and equipment it realized prior to its repeal. The unamortized ITC is being amortized over the lives of the property, plant and equipment, giving rise to the ITC.

HURON PROCEDURES AND INCOME TAX MFRs

Q. What procedures did Huron perform with respect to the company's income tax calculations?

A. The following procedures were performed by me or under my direct supervision:

1. We read the company's portion of TECO Energy, Inc.'s 2006 income tax return to identify the differences between book and taxable income. Schedule M of the tax return lists the book/tax differences. We did not review the 2007 tax return as it is currently being prepared and is not expected to be finalized and filed until September 15, 2008.
2. We obtained the supporting documentation for significant book/tax differences, noting that the book/tax differences were treated appropriately in the calculation of both current and deferred income tax expense and the related current and deferred balance sheet accounts for 2007 and the 2009 test year.
3. We reviewed the calculation of projected 2009 income tax expense and the methodology used to

determine such amounts. During this process, we focused on amounts treated as permanent differences, as these items impact the total income tax expense calculation.

4. We analyzed the roll-forward of ADIT from December 31, 2007 to December 31, 2009 based upon projected 2008 and 2009 activity.
5. We reviewed the documentation supporting the ITC amortization.
6. We read the relevant sections of prior FPSC Orders pertaining to income taxes.
7. We read the MFR schedules identified in Document No. 1 of my exhibit.
8. We compared the projected 2009 ADIT amounts included in the MFR income tax schedules to the IRC requirements for how such amounts are to be computed when a forecasted test period is used in a rate proceeding.

Q. Have there been recent changes in Federal tax policy that have been considered in this proceeding?

A. Yes. On February 13, 2008, the President of the United States signed the Economic Stimulus Act of 2008 (the "Act"). The Act allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified property for the 2008 and 2009 calendar years. This results in a larger book/tax difference for accelerated depreciation used for income tax depreciation versus straight-line depreciation used for financial reporting. Tampa Electric has reflected the impact of this provision in the 2009 MFRs.

Q. Are the income tax accounts reflected in the historical 2007 and forecasted 2009 MFRs computed appropriately?

A. Yes. Federal and state income tax expense has been correctly computed in the income statement in accordance with GAAP and the requirements of the FPSC. In addition, the computed income tax expense for 2007 and 2009 conforms with the requirements of the IRC, including the special provisions applicable to utilities.

The ADIT balances included in the MFRs are appropriate with one exception. The exception relates to an overstatement of ADIT resulting from a required true-up entry recorded on the books but erroneously omitted from the MFRs. The adjustment to correct for this omission is to reduce the ADIT balance by approximately $8.4

million. The adjustment was identified after the MFRs were completed and, had the MFRs correctly reflected the ADIT balance, there would be no impact to Tampa Electric's revenue requirement calculation.

Tampa Electric's income tax provision has been determined using a comprehensive interperiod income tax allocation. The company's tax computation is based on the revenues and expenses associated with the provision of its regulated utility service to its ratepayers. In this manner, the tax expense included in the revenue requirement calculation is the appropriate tax expense reflecting the tax consequences of the costs and revenues included in the establishment of the revenue requirement.

In addition, Tampa Electric's unamortized ITC is being amortized to tax expense over the book life of the related property. The amortization is "no more rapidly than ratably" in accordance with the IRC requirements.

IRC REQUIREMENTS FOR PROJECTED TEST PERIODS

Q. Has the company made any other material adjustments when computing income tax expense and deferred taxes for the 2009 test year?

A. Yes. My testimony addresses one further adjustment that has been made to comply with the normalization requirements of the IRC when a projected or forecast test period is used.

The ADIT balances on MFR Schedule D-1a, Cost of Capital, are based on a 13-month average of projected balances. However, the IRC requirements for projected test years require a specific computation to determine the maximum amount of ADIT to be treated as zero cost capital in the cost of capital calculation. The specific computation is shown on MFR Schedule D-1b, Cost of Capital-Adjustments, and reduces the ADIT included on MFR Schedule D-1a by $1,894,000. It is also shown on Document No. 2 of my exhibit. This adjustment is only required for accumulated deferred income taxes recorded in Account 282, net of the FAS 109 component, because this account includes the deferred taxes governed by the Internal Revenue Service ("IRS") normalization rules.

Q. Can you please describe the projected test year requirements of the IRC?

A. Yes. The IRC rules are set forth in Treasury Regulation Section 1.167(l)-1(h)(6) which address forecasted test periods and the appropriate amount of ADIT used to reduce rate base (or to be treated as zero cost capital in the determination of cost of capital) for a forecast test period. Specifically, these regulations require that:

> "for the purposes of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (I) of this subparagraph), if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for the period is the amount of the reserve (determined under subparagraph (2) of this paragraph) at the end of the historical period. If solely a future period is used for such determination, the amount of the reserve at the beginning of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged during a future period (or the future portion of a part-historical and part-future period) shall be determined by multiplying any such increase or decrease by a fraction, the numerator of which is the number

of days remaining in the period at the time such increase or decrease is to be accrued, and the denominator of which is the total number of days in the period (or future portion)."

Q. Tampa Electric has used a 2009 forecast test year in this proceeding. It expects new rates to be effective in May 2009. Do these rules apply to this situation?

A. Yes. Tampa Electric's revenue requirements are based on the 2009 13-month average balances of plant, accumulated depreciation and other rate base items. The 13-month average is developed based on the monthly rate base balances from December 2008 through December 2009. Similarly, the ADIT balances treated as a source of cost-free capital in the capital structure are also based on a 13-month average. Operating expenses, including depreciation expense and federal income tax expense, are based on the year ending December 31, 2009. This timing situation, where rates go into effect before the end of the test period is the situation wherein these IRC rules are applicable.

Q. Can you cite specific IRC guidance or interpretations to support your position?

A. Yes. There have been several private letter rulings ("PLRs") issued in instances with fact patterns similar to Tampa Electric's. The specific PLRs are PLR 9029040, PLR 9202029, PLR 9224040 and PLR 9313008. Although private letter rulings issued to specific taxpayers are not to be cited as precedent, they reflect IRS thinking on an issue and are consistently followed by the IRS. PLR 9029040, which states:

> "If rates go into effect before the end of the test period, and the rate base reduction is not prorated, the utility commission is denying a current return for accelerated depreciation benefits the utility is only projected to have. This procedure is a form of flow-through, for current rates are reduced to reflect the capital cost savings of accelerated depreciation deductions not yet claimed or accrued by the utility. Yet projected data is often necessary in determining rates, since historical data by itself is rarely an accurate indication of future utility operating results. Thus, the regulations provide that as long as the portion of the deferred tax reserve based on truly projected (future estimated) data is prorated according to the formula in section

1.167(l)-1(h)(6)(ii), a regulator may deduct this reserve from rate base in determining a utility's allowable return. In other words, a utility regulator using projected data in computing ratemaking tax expense and rate base exclusion must account for the passage of time if it is to avoid flow-through."

Q. Has the IRS defined "historical" versus "future" test periods as it relates to the pro rata ADIT calculation?

A. Yes. In PLR 9202029, the IRS provided the following guidance:

"Critical to the interpretation of section 1.167(l)-1(h)(6)(ii) of the regulation is the meaning of the terms "historical" and "future" in relation to the period for determining depreciation for ratemaking tax expense (this test period might not be consistent with the taxpayer's test year; see, e.g. section 1.167(l)-1(h)(6)(iv) Example (2)). The meaning of these terms does not depend on the type or quality of the data used in the ratemaking process--whether the data used is actual or estimated--but on when the utility's rates become effective. The historical period is that portion of the test period before rates go into effect, while the portion of the test period after the effective date of the rate order is the future period.

These date-based definitions of the terms "historical" and "future" are consistent with the purpose of normalization, which is to preserve for regulated utilities the benefit of accelerated depreciation as a source of cost-free capital. This cost-free capital is made available by prohibiting flow-through. But whether or not flow-through can be accomplished by means of a rate base exclusion depends primarily on whether, at the time rates become effective, the amounts originally projected to accrue to the deferred tax reserve have actually accrued."

In Tampa Electric's filing, the future portion of the test period subject to the pro rata guidance is the period from May 1, 2009 (the expected effective date of the rate change) to December 31, 2009 (the end of the projected test period).

Q. How did Tampa Electric address this requirement in determining the proper level of accumulated deferred taxes to be treated as cost-free capital in the forecast test period ended December 31, 2009?

A. Tampa Electric first determined the monthly projected balances for accumulated deferred income taxes for the year 2009. The monthly changes to accumulated deferred income taxes were based on the specific forecast of book and tax depreciation throughout the 2009 projected test period. These amounts were used to populate the 2009 MFRs related to monthly ADIT in accordance with the FPSC rules. Month-end ADIT balances from December 2008 through December 2009 are shown on MFR Schedule B-3, and a 13-month average is computed and summarized on MFR Schedule D-1a.

As explained previously, the average ADIT balance determined in this manner does not comply with the pro rata Treasury Regulations. The Treasury Regulations require that a pro rata calculation be used to determine the maximum amount of ADIT to be treated as cost-free capital in the cost of capital computation.

The monthly changes to ADIT were identified based on the specific forecast of book and tax depreciation throughout the 2009 projected test period. The January to April 2009 changes to ADIT were not prorated because they occur prior to the estimated May 2009 effective date of the rate increase (the "historical" portion of the test period as defined by the IRS). The projected changes to ADIT after the effective date of the rate increase are subject to the pro rata rules (the "future" portion of the test period). Thus, the forecasted May 2009 increase in ADIT was prorated using a numerator of 215 days and a denominator of 245 days (the number of days from the effective date of the rate change to the end of the forecast test period). The projected ADIT change in December 2009 was prorated using a numerator of one day and a denominator of 245 days.

Next, a 13-month average of the prorated monthly change in the ADIT balances for the test period was computed. This amount was compared to the 13-month average non-prorated 2009 monthly change in ADIT balances reflected on MFR Schedule B-3 and MFR Schedule D-1a and an adjustment of $1,894,000 million was computed. This adjustment is reflected on MFR Schedule D-1b and is necessary to state the projected 2009 ADIT balance to be treated as zero cost capital at the level required to comply with the forecast test period requirements set forth in Treasury Regulation Section 1.167(1)-1(h)(6).

Q. Once the ADIT for each month in the test period is determined using the pro rata methodology, why is it necessary to average the pro rata monthly ADIT balances?

A. When an average rate base is used, the pro rata monthly ADIT balances must also be averaged to comply with the consistency portion of the normalization requirements. In PLR 9224040, the IRS was requested to rule on the following issue:

> "Where an average rate base is used and where the test period is part historical and part future under section 1.167(1)-1(h)(6)(ii) of the regulations, whether the consistency rules of section 168(i)(9)(B) of the Code require the average rate base to be reduced by the average of (i) the estimated deferred taxes at the beginning of the test period and (ii) the prorated estimated deferred taxes at the end of the test period?"

The conclusion in that PLR is clear:

> "2. Where an average rate base is used and

where the test period is part historical and part future for purposes of section 1.167(l)-1(h)(6)(ii) of the regulations, failure to reduce the average rate base by the average of (i) the estimated deferred taxes at the beginning of the test period and (ii) the estimated deferred taxes at the end of the test period as prorated under section 1.167(l)-1(h)(6)(ii), will violate the consistency rules of section 168(i)(9)(B) of the Code."

Q. What are the consequences if Tampa Electric does not follow the pro rata rules of the IRS with respect to forecast test period ADIT?

A. Based on the Treasury Regulations and the PLRs I referenced, noncompliance with the Treasury Regulations would result in a form of flow-through that violates the normalization requirements of the IRC. As I explained previously, the penalty for violating the normalization requirements is the loss of the ability to claim accelerated depreciation on public utility property.

Q. Why is this pro rata averaging adjustment only required for the ADIT balances recorded in Account 282, net of the related FAS 109 component?

A. The ADIT recorded in Account 282, net of the related FAS 109 component; represent the deferred taxes subject to the IRS normalization rules. The remainder of the ADIT balances (Accounts 190,281 and 283) included as zero cost capital in the capital structure are not subject to the same requirements.

FIN 48

Q. Were any new income tax standards considered?

A. Yes. In June 2006, the FASB issued FASB Interpretation Number 48, <u>Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No 109, Accounting for Income Taxes (FIN 48).</u> FIN 48 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, a company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the position will be sustained on examination by the taxing authorities, based on the technical merit of the position.

Q. Please describe how this affects Tampa Electric.

A. The company adopted the provisions of FIN 48 effective January 1, 2007 with no impact. Tampa Electric does not have any uncertain tax positions at December 31, 2007 and has not projected any such positions in the 2009 MFRs.

SUMMARY

Q. Please summarize your direct testimony.

A. Tampa Electric has presented income tax schedules in accordance with the requirements of the Commission's MFRs. The income tax MFRs have been prepared based on comprehensive interperiod income tax allocation in accordance with GAAP and this Commission's long standing policies.

ITC amortization for the projected 2009 test period has been calculated and presented appropriately in accordance with GAAP and the requirements of the IRC.

The 2007 income tax MFRs present fairly the information required to be set forth therein in accordance with GAAP and the requirements for preparation of such schedules.

With the exception of the erroneously omitted $8.4 million ADIT adjustment discussed earlier in my direct testimony, the projected 2009 MFR income tax schedules have been presented on a basis consistent with the historical schedules and consistent with other projected information for the test period. Further, the projected 2009 MFR income tax amounts have been properly stated in accordance with GAAP and, with the adjustment included on MFR Schedule D-1b, have been calculated in accordance with the requirements of the IRC and Regulations applicable to projected test periods.

Q. Mr. Felsenthal, does this conclude your direct testimony?

A. Yes, it does.

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WITNESS: FELSENTHAL

EXHIBIT

OF

ALAN D. FELSENTHAL

ON BEHALF OF TAMPA ELECTRIC COMPANY

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LIST OF MINIMUM FILING REQUIREMENT SCHEDULES

SPONSORED OR CO-SPONSORED BY ALAN D. FELSENTHAL

MFR Schedule	Title
B-22	Total Accumulated Deferred Income Taxes
B-23	Investment Tax Credits-Annual Analysis
C-22	State And Federal Income Tax Calculation
C-25	Deferred Tax Adjustment
C-26	Income Tax Returns
C-27	Consolidated Tax Information
C-28	Miscellaneous Tax Information

CALCULATION OF IRC REQUIRED DEFERRED INCOME TAX ADJUSTMENT
(ACCOUNT 282)

	(A)	(B)	(C)	(D) (A*B/C=D)	(E) (From Col. D)	(F) (From Col. A)
Month	**Year 2009 Monthly Change**	**Days to Prorate**	**Calendar Days In Future Test Period**	**Monthly Change Prorated Test Year**	**Monthly Change Cumulative Prorated Balance**	**Cumulative Balance**
Annual Increase	**($21,246,426)**					
1/31/2009	(2,034,897)	N/A		(2,034,897)	(2,034,897)	(2,034,897)
2/28/2009	(2,012,308)	N/A		(2,012,308)	(4,047,205)	(4,047,205)
3/31/2009	(2,000,335)	N/A		(2,000,335)	(6,047,540)	(6,047,540)
4/30/2009	(1,974,697)	N/A		(1,974,697)	(8,022,237)	(8,022,237)
5/31/2009	(1,865,453)	215	245	(1,637,030)	(9,659,267)	(9,887,690)
6/30/2009	(1,757,811)	185	245	(1,327,327)	(10,986,594)	(11,645,501)
7/31/2009	(1,741,186)	154	245	(1,094,460)	(12,081,054)	(13,386,687)
8/31/2009	(1,734,030)	123	245	(870,554)	(12,951,607)	(15,120,717)
9/30/2009	(1,637,822)	93	245	(621,704)	(13,573,311)	(16,758,539)
10/31/2009	(1,539,836)	62	245	(389,673)	(13,962,984)	(18,298,375)
11/30/2009	(1,530,146)	32	245	(199,856)	(14,162,840)	(19,828,522)
12/31/2009	(1,417,905)	1	245	(5,787)	(14,168,627)	(21,246,426)
Total	**($21,246,426)**			**($14,168,627)**	**($121,698,163)**	**($146,324,336)**
Months					13	13
13 Month Average					($9,361,397)	($11,255,718)
Difference - Adjustment to Reduce ADIT to Prorated 13 Month Average					$1,894,321	

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