

**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**

**REBUTTAL TESTIMONY
OF
ALAN D. FELSENTHAL
ON BEHALF OF TAMPA ELECTRIC COMPANY**

DOCUMENT NUMBER - DATE

11646-0803178

FPSC-COMMISSION CLERK

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

REBUTTAL TESTIMONY

OF

ALAN D. FELSENTHAL

ON BEHALF OF TAMPA ELECTRIC COMPANY

DOCUMENT NUMBER-DATE

11646 DEC 17 80

FPSC-COMMISSION CLERK

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

TABLE OF CONTENTS
REBUTTAL TESTIMONY AND EXHIBIT
OF
ALAN D. FELSENTHAL
ON BEHALF OF TAMPA ELECTRIC COMPANY

AMORTIZATION OF INVESTMENT TAX CREDIT..... 3
ACCUMULATED DEFERRED INCOME TAX ADJUSTMENT..... 18
RELIANCE ON PRIVATE LETTER RULINGS..... 26
SUMMARY OF REBUTTAL TESTIMONY..... 29

DOCUMENT NUMBER-DATE
11646 DEC 17 88
FPSC-COMMISSION CLERK

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **REBUTTAL TESTIMONY**

3 **OF**

4 **ALAN D. FELSENTHAL**

5 **ON BEHALF OF TAMPA ELECTRIC COMPANY**

6
7 **Q.** Please state your name, business address, occupation and
8 employer.

9
10 **A.** My name is Alan D. Felsenthal. My business address is
11 550 West Van Buren Street, Chicago, Illinois 60607. I am
12 a Managing Director at Huron Consulting Group.

13
14 **Q.** Are you the same Alan D. Felsenthal who filed direct
15 testimony in this proceeding?

16
17 **A.** Yes, I am.

18
19 **Q.** What is the purpose of your rebuttal testimony?

20
21 **A.** The purpose of my rebuttal testimony is to address
22 certain income tax-related issues raised in the prepared
23 direct testimony of Mr. Helmuth Schultz and Mr. Hugh
24 Larkin, testifying on behalf of Office of Public Counsel
25 ("OPC").

1 Q. Please summarize the disagreements you have regarding the
2 substance of the income tax positions included in the
3 testimony of Messrs. Schultz and Larkin and describe the
4 purpose of your rebuttal testimony.

5
6 A. My disagreements are as follows:

7 • Messrs. Schultz and Larkin do not accept the revision
8 made by Tampa Electric related to the amortization of
9 Investment Tax Credit ("ITC"). This change to the
10 amortization amount is necessary for Tampa Electric to
11 comply with the normalization requirements of the
12 Internal Revenue Code ("IRC"). My rebuttal testimony
13 explains the nature of the revision and why it must be
14 made for Tampa Electric to avoid the adverse
15 consequences of violating the IRC requirements.

16
17 • Messrs. Schultz and Larkin object to the Accumulated
18 Deferred Income Tax ("ADIT") adjustment explained in
19 my direct testimony that is required to comply with
20 the normalization requirements of the IRC when a
21 forecast test period is used. My rebuttal testimony
22 will further explain why this adjustment is necessary
23 and the potential consequences to Tampa Electric if
24 the position of the OPC witnesses is accepted.

25

1 • In both cases, my testimony is based partially on
2 interpretations of the IRC included in Private Letter
3 Rulings ("PLR") and Messrs. Schultz and Larkin imply
4 that such interpretations should be given little, if
5 any, weight in this proceeding. In my rebuttal
6 testimony I explain why this Commission should
7 consider the interpretations included in those PLRs
8 when addressing the specific income tax issues in this
9 proceeding.

10
11 **AMORTIZATION OF INVESTMENT TAX CREDIT**

12 **Q.** What is the Investment Tax Credit or ITC?

13
14 **A.** As explained in my direct testimony, the ITC provides
15 taxpayers an incentive to make capital investments by
16 granting a tax credit (a direct dollar for dollar offset
17 to current taxes payable) to taxpayers calculated by
18 applying a percentage rate to investment in tangible
19 personal property including most generation, transmission
20 and distribution assets. The intent of the ITC is to
21 reduce the net cost of acquiring depreciable property,
22 thereby providing taxpayers an incentive to invest in
23 qualifying assets. To make sure that its objectives are
24 met for investments in qualifying utility property, the
25 IRC prescribes methods of sharing the benefit between the

1 ratepayers and the shareholders.

2

3 **Q.** What journal entries are required to account for the ITC?

4

5 **A.** The journal entries can best be illustrated with an
6 example. Assume that in 1985, a public utility spent \$100
7 million in acquiring tangible assets (generating
8 facilities) that qualified for the ITC. Also assume that
9 the ITC percentage or rate was eight percent in that
10 year. The entity would be entitled to an \$8 million ITC,
11 which is a direct reduction of the entity's tax expense.

12

13	Current Taxes Payable	\$8 million
14	Current Tax Expense	\$8 million

15

16 In effect, the net cost of the acquired capital asset
17 would be \$92 million (\$100 million incurred less an \$8
18 million reduction in income taxes).

19

20 The journal entries do not stop here. Rather than
21 reflecting the realized ITC in net income in the year
22 realized, most public utilities defer the ITC and
23 amortize the unamortized ITC over the life of the asset
24 that gave rise to the ITC in the first place.

25

1 The entry to defer the ITC in the year claimed is as
2 follows:

3
4 Current Tax Expense \$8 million
5 Unamortized ITC \$8 million
6

7 Assuming the \$100 million tangible asset used in this
8 example has a 20-year life, the following entry would
9 result in each year 1 through 20:

10
11 Unamortized ITC \$400,000
12 Income Tax Expense \$400,000
13

14 In this manner, each year's net income would include
15 depreciation expense of \$5 million (\$100 million divided
16 by 20) and ITC amortization of \$400,000, or a net of \$4.6
17 million. You would get this same result if the "net
18 cost" of the asset, \$92 million, were depreciated over 20
19 years.
20

21 **Q.** How is the ITC treated for ratemaking purposes?
22

23 **A.** For ratemaking purposes, in 1972 utilities were required
24 by the IRC to elect how they intended to share the ITC
25 between ratepayers and shareholders. Most utilities,

1 including Tampa Electric, elected to share the ITC by
2 including the annual amortization to income tax expense
3 as an "above the line" reduction, which reduced income
4 tax expense thereby benefiting ratepayers. The
5 unamortized amounts were not used to reduce rate base
6 thereby benefiting shareholders who were entitled to earn
7 on property, plant and equipment financed partially by
8 the ITC "grant" or "rebate".
9

10 Tampa Electric's current filing reflects the unamortized
11 ITC balance of property, plant, and equipment realized on
12 tax returns prior to the repeal of the ITC as a result of
13 the 1986 Tax Reform Act. The unamortized ITC is being
14 amortized over the lives of the property, plant, and
15 equipment giving rise to the ITC.
16

17 **Q.** Mr. Schultz states on pages 37 and 38 of his direct
18 testimony that he requires additional information with
19 respect to how the ITC amortization change "was reflected
20 in the filing". Can you please describe the ITC
21 amortization change and provide additional information?
22

23 **A.** Yes. Under the ITC election made by Tampa Electric, the
24 unamortized ITC is to be amortized over the book life of
25 the asset generating the ITC. While reviewing the income

1 tax MFRs, we noted that Tampa Electric was amortizing the
2 ITC using the composite depreciation rate of the assets
3 giving rise to the ITC. This rate included not only the
4 recovery of the asset over its estimated useful life but
5 also included factors for interim retirements and
6 negative salvage. However, the IRC requirements make it
7 clear that ITC amortization should be based solely on the
8 depreciable lives and should exclude interim retirement
9 and salvage value factors. Use of the combined
10 depreciation rate results in ITC being fully amortized
11 before the related asset is fully depreciated.

12
13 When Tampa Electric stripped these other factors out of
14 the computation, a revised rate based solely on the asset
15 lives was computed and used to calculate the annual
16 amortization in order to comply with the IRC requirements
17 for ITC amortization. The company made the appropriate
18 adjustment in its financial statements effective in the
19 second quarter of 2008. This change resulted in a
20 decrease in ITC amortization in 2008 and 2009, which can
21 be seen on Minimum Filing Requirements ("MFR") Schedule
22 B-23, Column 4, Rows 18 and 19. Because Tampa Electric
23 revised the ITC amortization in this manner, a pro forma
24 adjustment was not required. It is also important to
25 note that the book lives of certain generation assets

1 were extended in connection with the 2007 Tampa Electric
2 depreciation study, further contributing to the reduction
3 in ITC amortization.
4

5 **Q.** Can you please quantify the impact on the ITC
6 amortization recorded on the books by Tampa Electric and
7 included in the MFRs resulting from revising the
8 amortization rate to include only the depreciation life
9 component?
10

11 **A.** Yes. The following is the estimated annual impact:
12

- 13 • \$2,435,000 2007 historical ITC amortization
14 based on a depreciation rate
15 including life, interim retirements
16 and cost of removal factors
17
- 18 • \$368,000 2009 projected ITC amortization based
19 on a depreciation rate including life
20 only
21
- 22 • \$2,067,000 Annual reduction primarily related to
23 the revised ITC amortization rate
24

25 The large reduction in the ITC amortization amount is due

1 to the combination of 1) removing cost of removal and
2 interim retirement impacts from the depreciation rate and
3 2) the lowering of the life component of the depreciation
4 rate to reflect significant life extensions on generation
5 plant resulting from the 2007 depreciation study. The
6 generating station that contributed to the majority of
7 the year end 2007 unamortized ITC balance was Big Bend
8 Unit 4. Based on the 2007 depreciation study, the life
9 of this asset was extended, thereby extending the period
10 of time over which to amortize ITC as well.

11
12 **Q.** Can you further distinguish between the composite
13 depreciation rate used to depreciate property, plant and
14 equipment and the depreciation life?

15
16 **A.** Yes. The depreciation life is generally one component of
17 the depreciation rate. The cost of an asset is
18 depreciated over its estimated useful life in a
19 systematic and rational manner (generally straight-line),
20 so at the end of its useful life, the plant asset has
21 been fully recovered through depreciation charges. In my
22 previous example, the cost of the asset, \$100 million, is
23 depreciated on a straight-line basis over an estimated
24 useful life of 20 years. A 20-year life converts to a
25 five percent annual depreciation rate ($1/20 = 5$ percent),

1 which when applied to the cost of the asset results in
2 annual depreciation expense of \$5 million.

3
4 When the asset is retired, there can be a salvage value,
5 a cost to remove or dismantle the fixed asset, or both.
6 When depreciation studies are performed, these additional
7 factors are considered in determining the annual
8 depreciation rate. The original cost of the fixed asset
9 is reduced by the estimated salvage value, and the net
10 original cost is used as the basis for depreciation. For
11 example, assume that the \$100 million property, plant,
12 and equipment have an estimated salvage value of \$6
13 million. The net cost to be recovered through annual
14 charges is now \$94 million or \$4.7 million per year. The
15 annual rate to apply to the \$100 million asset is now 4.7
16 percent.

17
18 Most utility property requires a cost to be incurred to
19 remove or dismantle the asset upon retirement. This cost
20 would also be considered in developing an annual
21 depreciation rate. Continuing with the example, assume
22 that it is estimated to cost \$16 million to remove the
23 asset upon retirement. In such a case, the "net negative
24 salvage" is \$10 million (\$6 million salvage less \$16
25 million to remove). The net cost to be recovered through

1 annual charges over the 20-year life is \$110 million,
2 \$5.5 million per year, converted to a depreciation rate
3 of 5.5 percent.

4
5 The 5.5 percent rate converts to a life of 18.18 (1
6 divided by 5.5 percent). Therefore, if the 5.5 percent
7 rate were applied to the unamortized ITC balance, that
8 balance would be fully amortized in 18.2 years, which is
9 faster than the asset's estimated useful life of 20
10 years.

11
12 In summary, the depreciation rates used by Tampa Electric
13 and most utilities include factors to recover the asset
14 over its estimated useful life as well as estimates of
15 salvage and removal costs anticipated upon retirement of
16 the asset. A five percent rate represents recovery of
17 the asset based only on its 20-year life. A 5.5 percent
18 rate represents recovery of the asset based on its life
19 as well as a factor representing the estimated cost to
20 remove the asset upon retirement. In order to comply
21 with the IRC rules, ITC amortization must be based upon
22 the five percent rate (corresponding to a 20-year life),
23 the book depreciation rate exclusive of cost of removal.
24 Use of the 5.5 percent would share ITC with ratepayers
25 more rapidly than the book life and would result in a

1 normalization violation.

2

3 **Q.** What are some other factors considered in the
4 determination of the depreciation rate?

5

6 **A.** When developing a depreciation rate, an entity may
7 include a factor for interim retirements to recognize
8 that some component parts of an asset will need to be
9 replaced prior to the retirement of the larger property
10 unit. A factor for interim retirements also has the
11 effect of increasing the depreciation rate.

12

13 **Q.** Why is it important to compute annual ITC amortization
14 using only the estimated useful lives included in the
15 depreciation computation and not the combined
16 depreciation rate?

17

18 **A.** The specific section in the IRC (Section 46 (f)(2))
19 refers to amortizing the ITC in a "ratable" manner and if
20 amortization is "more than a ratable portion", no ITC
21 will be permitted. In other words, if more than a
22 ratable portion of ITC is used to reduce income tax
23 expense, a violation of the IRC will occur and the
24 taxpayer will have to refund to the IRS any unamortized
25 ITC.

1 Under section 1.46-6(g)(2) of the IRC regulations,
2 ratable is to be determined by considering the time
3 actually used in computing depreciation expense for the
4 property giving rise to the ITC.

5
6 **Q.** Has the IRS published PLRs addressing this issue?

7
8 **A.** Yes. The IRS has issued a number of rulings on this
9 specific issue; that is, whether amortizing ITC using a
10 depreciation rate that includes interim retirements
11 and/or cost of removal is "more than a ratable portion"
12 and would cause a violation of the IRC requirements.

13
14 For instance, PLR 9023080, issued in the early 1990's
15 addressed the specific issue of whether a violation would
16 result if ITC were amortized using a depreciation rate
17 that included a factor for interim retirements. The
18 thrust of the PLR is that using a depreciation rate that
19 includes such a factor would result in the ITC being
20 fully amortized before the related asset is fully
21 depreciated, which is clearly a violation of the "more
22 than ratable" language in the IRC and regulations.

23
24 **Q.** The PLR you just cited is from the early 1990's. Has
25 there been more recent guidance?

1 **A.** Yes. In PLR 200802025, released January 11, 2008, a fact
2 pattern similar to that of Tampa Electric's was
3 addressed. In that release, the IRS concluded:

4
5 "Under section 1.46-6(g)(2) of the regulations,
6 "ratable" for purposes of former section 46(f)(2)
7 of the Code is determined by considering the
8 period of time actually used in computing the
9 taxpayer's regulated depreciation expense for the
10 property for which a credit is allowed.
11 Regulated depreciation expense is the
12 depreciation expense for the property used by a
13 regulatory body for purposes of establishing the
14 taxpayer's cost of service for ratemaking
15 purposes. Such period of time shall be expressed
16 in units of years (or shorter periods), units of
17 production, or machine hours and shall be
18 determined in accordance with the individual
19 useful life or composite (or other group asset)
20 account system actually used in computing the
21 taxpayer's regulated expense. A method of
22 reducing is ratable if the amount to reduce cost
23 of service is allocated ratably in proportion to
24 the number of such units. Thus, for example,
25 assume that the regulated depreciation expense is

1 computed under the straight line method by
2 applying a composite annual percentage rate to
3 original cost (as defined for purposes of
4 computing depreciation expense). If cost of
5 service is reduced annually by an amount computed
6 by applying a composite annual percentage rate to
7 the amount of the credit, cost of service is
8 reduced by a ratable portion. A composite annual
9 percentage rate is determined solely by reference
10 to the period of time actually used by the
11 taxpayer in computing its regulated depreciation
12 expense without reduction for salvage or other
13 items such as over and under accruals."

14 (Underlining added)

15
16 Two more PLRs (200811004 and 200802026) were recently
17 issued with a similar conclusion.

18
19 **Q.** On page 6 of his direct testimony, Mr. Larkin suggests
20 that the "proposed change" to the ITC amortization rates
21 is "for a problem which does not exist". Do you agree
22 with his assessment?

23
24 **A.** No. As explained above, the ITC amortization is not a
25 proposed change. Rather, it is an actual change that has

1 already been made by the company and is necessary to
2 comply with the requirements of the IRC. The change in
3 the ITC amortization is reflected in the Tampa Electric
4 financial statements beginning with the second quarter of
5 2008.

6
7 **Q.** Because Tampa Electric had been amortizing ITC using the
8 depreciation rate rather than the depreciation life for a
9 number of years, is there a potential issue with the IRC
10 for this past practice?

11
12 **A.** No, not based on recent guidance contained in several
13 PLRs. Both PLRs 200802025 and 200802026 provide guidance
14 for regulated electric utilities that inadvertently
15 included a factor for cost of removal when developing the
16 ITC amortization rate and related ITC amortization. The
17 PLRs conclude that a normalization violation would
18 generally occur if the ITC amortization includes a factor
19 for cost or removal because, in such a circumstance, the
20 ITC amortization would be flowed to ratepayers more
21 rapidly than allowed by IRS rules. The IRS concluded that
22 (as is the case with Tampa Electric) because this
23 violation was through an oversight, was unintentional and
24 that the regulator was unaware that the ITC amortization
25 rate included an element for cost of removal (negative

1 net salvage) when reaching past regulatory decisions
2 regarding the utility, these situations did not result in
3 normalization violations. In PLR 200802025, the
4 following conclusion was reached:

5 "For the periods during which Taxpayer included
6 negative net salvage in its calculation of asset
7 life for ITC purposes, it appears that the
8 practical effect of that action was to flow the
9 ITC to ratepayers more rapidly than if calculated
10 without the negative net salvage. However, this
11 was not the intent of either the Taxpayer or
12 either Commission A or Commission B. In accord
13 with the Senate Reports quoted above,
14 disallowance or recapture of the ITC should be
15 imposed, if at all, only after a regulatory body
16 has required or insisted upon such treatment by a
17 utility. Because Commission A and Commission B at
18 all times required that Taxpayer comply with the
19 normalization tax rules and because the matter of
20 the ITC flow-through calculation was not
21 specifically addressed in the earlier orders by
22 either of the Commissions, no disallowance or
23 recapture is required in this case. Except as
24 specifically determined above, no opinion is
25 expressed or implied concerning the Federal

1 income tax consequences of the matters described
2 above. In particular, orders concerning this
3 matter finalized by either of the Commissions
4 after the date of this ruling are not necessarily
5 subject to the same analysis as those considered
6 above."

7
8 Now that Tampa Electric has discovered and adjusted its
9 books and rate request to incorporate the appropriate
10 amortization period for ITC and the issue has been raised
11 in the context of this rate proceeding, an inadvertent or
12 unintentional claim can no longer be raised.

13
14 **ACCUMULATED DEFERRED INCOME TAX ADJUSTMENT**

15 **Q.** In your direct testimony, you describe the IRC
16 requirement to pro rate the ADIT balance when a forecast
17 test period is used and propose an adjustment to the ADIT
18 balance to comply with the IRS requirement. The pro rata
19 ADIT computation is required for the period of the
20 projected or forecast test year that occurs after the
21 effective date of the rate order (referred to as the
22 "future portion of the forecast test period as opposed to
23 the "historic" portion of the forecast test period). In
24 Tampa Electric's case, a 2009 forecast test period is
25 used and new rates are expected to be effective in May

1 2009. Thus, the "future" portion of the forecast test
2 period is the period from May 2009 through December 2009
3 and the "historic" portion of the future test period is
4 January 1, 2009 through April 30, 2009. You cite
5 specific PLRs in support of this ADIT adjustment of
6 \$1,894,321.

7
8 On page 35 of his direct testimony Mr. Schultz states
9 that the PLRs that you rely on define historic and future
10 periods consistently for purposes of prorating ADIT, but
11 "the IRS could apply a different definition in a
12 subsequent letter ruling since each letter ruling only
13 applies to an individual company". Do you agree with
14 this statement?

15
16 **A.** Yes. However, as I indicate later in my rebuttal
17 testimony, the fact that the IRS has ruled consistently
18 on what is meant by "historic" and "future" portions of
19 forecast test periods in four PLRs makes it highly
20 probable that they will rule in a similar manner in the
21 future.

22
23 **Q.** Also on page 35 of his direct testimony, Mr. Schultz
24 says, "two of the three letter rulings that Mr.
25 Felsenthal has relied upon do not indicate the period

1 used so again facts are missing". Does the fact that the
2 specific dates are not included in the ruling affect your
3 conclusion?
4

5 **A.** No, not at all. Specific dates and time periods are
6 oftentimes redacted in published PLRs to help mask the
7 identity of the entity requesting the PLR. Whether the
8 specific time periods are redacted or not is not relevant
9 to the issue at hand. Each PLR referred to in my direct
10 testimony deals with whether the ADIT proration required
11 by the IRS rules should be performed or not. The key
12 determinant of the proration in each PLR is whether a
13 projected or forecast test period is used, and whether
14 the proposed rates go into effect before the end of the
15 projected test period (the "historic" or "future" portion
16 of the forecast test period).
17

18 **Q.** On pages 35 and 36 of his direct testimony, Mr. Schultz
19 indicates that the manner in which the average rate base
20 is computed may be a relevant consideration. He indicates
21 that a simple average of beginning of period and end of
22 period deferred income tax balances may have been used in
23 the rate proceedings and fact patterns referred to in
24 these PLRs as opposed to the 13-month weighted average
25 balance included in Tampa Electric's MFRs in this

1 proceeding. Assuming that Mr. Schultz is correct and
2 only a simple average was used in the rate proceedings
3 prompting the PLRs you have cited, do you agree that a
4 different finding would have occurred if a 13-month ADIT
5 averaging had been performed?
6

7 **A.** No. Each method serves to compute an average rate base.
8 One method uses two data points and the other method uses
9 thirteen data points. Based on the reasoning cited in
10 the PLRs, neither of the averaging techniques absolves
11 the company from performing the pro rata calculation when
12 a projected test period is used and the rates go into
13 effect before the end of the forecast test period.
14

15 **Q.** On page 36 of his direct testimony, Mr. Schultz presents
16 his view that the 13-month averaging technique is similar
17 to a pro rata calculation. He states, "A thirteen month
18 average reflects the deferred tax balance at the
19 beginning of a year and the pro rata portion of each
20 month added during the year. The regulations do specify
21 that the pro rata calculation is done based on days so
22 the determination that must be made is whether the
23 calculation based on days is materially different to
24 require a change in rate making across the country that
25 has utilized a pro-ration based on months." Can you

1 comment on this assertion?

2

3 **A.** Yes. The key conclusion in PLR 9202029 is that averaging
4 and prorating are different concepts. In situations
5 involving a forecast test period with rates effective
6 before the test period is completed, a normalization
7 violation would occur if the average ADIT balance is used
8 as zero cost capital and such balance exceeds the ADIT
9 balance determined using the specific pro rata formula.

10

11 In PLR 9202029, the staff of the commission of the
12 utility requesting the ruling suggested that averaging
13 was equivalent to prorating and required the utility to
14 seek the IRS guidance on the issue. The PLR summarizes
15 the commission staff's position as: "The Commission staff
16 responds that proration is the functional equivalent of
17 averaging...". In that PLR, the IRS rejected the staff
18 position by stating:

19

20 "The staff's position confuses function with
21 purpose. Proration is mathematically similar to
22 averaging, but the two techniques serve different
23 purposes. Proration is a crude way of discounting
24 the amount of deferred taxes (cost-free capital)
25 the utility expects to recognize sometime in the
future. Averaging, on the other hand, is simply

1 the Commission's chosen method of estimating the
2 test year rate base (it very well could have
3 projected an end-of-period rate base, for
4 example). Both ends are legitimate, but they
5 cannot be served by one means.

6
7 If an average test year rate base is used in
8 developing rates, all rate base components,
9 including the deferred tax reserve, must be
10 averaged. If the proration of deferred tax
11 accruals substitutes for taking the average of
12 the entire reserve, then the consistency
13 requirement of section 168(i)(9)(B) will be
14 violated (the projected deferred tax reserve will
15 not be consistent with the projected rate base).
16 Likewise, if a portion of the test year is a
17 future period, projected accruals to the deferred
18 tax reserve must be prorated. If averaging of the
19 entire reserve substitutes for this proration,
20 then the timing requirement of section 1.167(l)-
21 1(h)(6) will be violated (too much will be
22 excluded from rate base, thus denying the utility
23 a return on "capital" it is only projected to
24 have)." (Underlining added).

1 It is clear from the ruling that the IRS believes that
2 proration and averaging are different concepts serving
3 different purposes.
4

5 **Q.** On page 35 of his direct testimony, Mr. Schultz indicates
6 that "letter ruling 9029040 as stated earlier does not
7 identify the periods which is important because if that
8 ruling is based on an end of period rate base the facts
9 are definitely different from the facts presented in this
10 case." Do you agree that the facts in this PLR are
11 different than the facts presented in this case?
12

13 **A.** Yes. However, this PLR was referred to because it gives
14 guidance on when proration is necessary. This particular
15 PLR addressed a forecast test period with an end of
16 period rate base, with the effective date of the new
17 rates occurring after the end of the forecast test year.
18 Because in this PLR, the effective date of the new rates
19 was after the end of the test year, this PLR concluded
20 that no proration was necessary. It also gives guidance
21 consistent with the other three PLRs referenced.
22

23 **Q.** On page 34 of his direct testimony, Mr. Schultz states
24 "Mr. Felsenthal bases his position on the incorrect
25 assumption that the projected costs for 2009 are in

1 reality part historic and part projected." Do you agree
2 with his assertion?

3
4 **A.** No. I have applied the definitions of historic and
5 future consistent with the IRS guidance reflected in
6 these PLRs. PLR 9202029 states, "The historical period
7 is that portion of the test period before rates go into
8 effect, while the portion of the test period after the
9 effective date of the rate order is the future period."
10 Thus, the period from January 1, 2009 through April 30,
11 2009 is the historical portion of the projected year as
12 defined in the guidance of the IRS." The IRS has
13 remained consistent in their definitions throughout the
14 four PLRs referenced above and included in my direct
15 testimony.

16
17 **Q.** On page 37 of his direct testimony, Mr. Schultz states
18 that "If Mr. Felsenthal's position is adopted that would
19 mean the Company has been in violation of normalization
20 requirements at least since rates were set in February
21 1993." Do you agree?

22
23 **A.** No. Based on the PLRs I cite above related to ITC
24 amortization and the fact that the company's past actions
25 were inadvertent, the IRS would likely not find a

1 normalization violation back to 1993. Rather, they would
2 require the situation to be remedied going forward, which
3 is exactly what Tampa Electric has done.
4

5 **RELIANCE ON PRIVATE LETTER RULINGS**

6 **Q.** On page 35 of his direct testimony, Mr. Schultz states
7 that the PLRs you refer to in your direct testimony "do
8 not reveal all the important facts that must be known if
9 any credence should be placed on the ruling themselves."
10 Do you agree with this statement?
11

12 **A.** No. All pertinent facts of the letter request and related
13 IRS ruling are included in the PLR itself. Ample
14 background, relevance and rationale for the rulings are
15 included in the referenced PLRs. In addition, there is
16 an added requirement in the PLR process applicable to
17 utilities seeking interpretations of potential
18 normalization violations. The facts included in such
19 letter requests must be agreed to by the respective
20 regulatory commission and the taxpayer prior to
21 submitting the request to the IRS. The entire process
22 can be costly and time consuming.
23

24 **Q.** The OPC witnesses contend that PLRs are only applicable
25 to the taxpayer who requests the ruling and cannot be

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

used as precedent for others. Do you agree?

A. Yes, but certain other factors must be considered. PLRs clearly show the thinking of the IRS with respect to interpreting the IRC and the related regulations. In addition, the IRS strives to achieve consistency in its interpretations of the tax statute and regulations. On the issue of the requirement to pro rate ADIT when a forecast test period is used, the IRS has issued four PLRs that build on each other and reach the same consistent result. Similarly, on the issue of ITC amortization, the IRS has ruled consistently in a number of PLRs. Given the consistency of the PLRs, it is highly probable that a similar request on a similar issue by another taxpayer will likely result in a similar ruling.

All PLRs are published and made available to tax professionals and the taxpaying public. The process of publishing the rulings assists other taxpayers with similar fact patterns, avoids the requirement to prepare a ruling request and avoids the need for additional effort by the IRS to respond to such requests when there is a clear interpretation of the IRS position expressed in the PLRs.

1 The fact that a PLR is binding only on the taxpayer
2 requesting it does not mean that the IRS does not use a
3 reasoned and consistent approach to support its decision.
4 Because the IRS is the administrative agency that
5 interprets the tax rules, published PLRs clearly reveal
6 the agency's interpretation of the tax rules. As such,
7 PLRs can be instructive to other taxpayers.

8
9 **Q.** On page 34 of his direct testimony, Mr. Schultz states,
10 "the Company has consistently accounted for deferred
11 income taxes and investment tax credits for years under
12 the method that Mr. Felsenthal now claims is incorrect,
13 despite repetitive audits where no errors were found by
14 the Internal Revenue Service (IRS)". Would you expect an
15 IRS audit to identify the ITC amortization and the
16 deferred tax pro rata adjustment?

17
18 **A.** No, it is not surprising that an IRS audit would not
19 identify these matters. The scope of an IRS audit varies
20 from company to company but generally focuses on current
21 revenue and current deductions included in the tax
22 return. The deferred tax pro rata adjustment is not an
23 actual adjustment to the ADIT balances. Rather, it is an
24 adjustment in rate filings to determine the appropriate
25 level of zero cost capital used to set rates.

1 Accordingly, there would be nothing in the books and
2 records of Tampa Electric with respect to this item.
3 Second, IRS audits related to the investment tax credit
4 would likely focus on the investment tax credit generated
5 or realized in the year such ITC directly reduces current
6 federal income tax payable. ITC amortization would not
7 be subject to audit by the IRS because such amortization
8 does not impact the current tax expense or the current
9 year return.

10
11 **SUMMARY OF REBUTTAL TESTIMONY**

12 **Q.** Please summarize your rebuttal testimony.

13
14 **A.** Tampa Electric adjusted its ITC amortization rate from a
15 rate, which included factors for life, interim
16 retirements and cost of removal to a rate that only
17 includes a factor representing the estimated useful life
18 of the asset. The adjustment is necessary to comply with
19 IRC requirements stating that ITC amortization should be
20 over the life of the property giving rise to the ITC.
21 The ITC amortization included in the projected test year
22 (2009) MFRs reflects the appropriate amortization period.

23
24 The IRC, regulations and a number of PLRs contain
25 guidance on the maximum amount of ADIT that can be

1 treated as zero-cost capital in the return calculation
2 when a forecast test period is used. Including more than
3 the maximum level of ADIT as zero cost capital could
4 result in a violation of the IRC normalization rules,
5 with significant consequences. Tampa Electric has made an
6 adjustment in its filing to comply with these
7 requirements. While PLRs apply only to the taxpayer
8 requesting them, they express the interpretations and
9 reasoning of the IRS and are instructive to other
10 taxpayers. Four separate PLRs have been issued relating
11 to this issue and the IRS has reached consistent
12 conclusions in each one.

13

14 **Q.** Does this conclude your rebuttal testimony?

15

16 **A.** Yes, it does.

17

18

19

20

21

22

23

24

25