

Direct Testimony
John R. Wilde

Before the Minnesota Public Utilities Commission
State of Minnesota

In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to
Increase Rates for Natural Gas Service in Minnesota

Docket No. G011/GR-13-617
Exhibit _____

Direct Testimony

Tax Matters

September 30, 2013

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1 **I. INTRODUCTION AND QUALIFICATIONS**

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is John R. Wilde. My business address is Integrys Energy Group, Inc.
4 (“Integrys”), 700 North Adams Street, P.O. Box 19001, Green Bay, WI 54307-9001.

5
6 Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR BUSINESS POSITION?

7 A. My title is Vice President-Tax, and I am employed by Integrys Business Support, LLC
8 (“IBS”). I am responsible for the tax function for Integrys and its subsidiaries including
9 Minnesota Energy Resources Corporation (“MERC”).

10
11 Q. PLEASE SUMMARIZE YOUR QUALIFICATIONS AND EXPERIENCE.

12 A. I graduated from Saint Norbert College, De Pere, Wisconsin in 1984 with a Bachelor of
13 Business Administration degree in Accounting. I have a graduate certificate in state and
14 local taxation, as well as Masters of Science Degree in Taxation, from the University of
15 Wisconsin-Milwaukee. I have been employed by Integrys or its predecessors since 1984,
16 and since 1986 I have been employed in the Tax Department.

17
18 Q. FOR WHOM ARE YOU PROVIDING TESTIMONY?

19 A. I am providing testimony on behalf of MERC.

20
21 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

1 A. I present and support MERC’s treatment in the instant rate case of a federal tax Net
2 Operating Loss (“NOL”) carryover from 2013 and 2014 by applying long standing
3 regulatory practices related to accounting for income taxes.

4
5 Additionally, I present and support MERC’s regulatory accounting treatment of the re-
6 measurement of deferred tax balances caused by recent changes in tax law related to post
7 retirement medical obligations and the Medicare subsidy. These changes were created
8 with the enactment of the Patient Protection and Affordable Care Act (“PPACA”), and
9 the Health Care and Education Affordability Reconciliation Act of 2010 (“HCEARA”).
10 These acts were signed into law on March 23, 2010 and March 30, 2010, respectively.

11
12 Also, I present and support an update on MERC’s 2011, 2012, 2013 and 2014 property
13 tax obligations.

14
15 Q. ARE YOU SPONSORING ANY EXHIBITS IN CONNECTION WITH YOUR
16 TESTIMONY IN THIS PROCEEDING?

17 A. Yes, I am. I am sponsoring one exhibit, Exhibit ____ (JRW-1), which is a calculation of
18 MERC’s estimated 2012-2014 property tax obligations by taxing authority.

19

1 **II. ACCOUNTING FOR A FEDERAL TAX NET OPERATING LOSS (“NOL”)**
2 **CARRYOVER**

3 Q. FOR THE 2014 TEST YEAR, HAS MERC INCLUDED A DEFERRED TAX ASSET
4 RELATED TO A FEDERAL NOL?

5 A. Yes, MERC has included a deferred tax asset (“DTA”) for a NOL carryforward. The
6 DTA represents MERC’s stand-alone operating income NOL that arose in 2012 and
7 2013 due primarily to bonus depreciation.

8
9 Q. HAS MERC RECENTLY EXPERIENCED NOL?

10 A. MERC has experienced several consecutive years of NOLs, primarily due to
11 bonus tax depreciation deductions. Until this rate case, MERC was not
12 in the position of having to reflect the related allowance for deferred income taxes related
13 to a carryforward of a NOL balance from any prior year.

14
15 Q. WHAT CAUSED MERC’S NOL AND THE CARRYFORWARD OF THAT TAX
16 BENEFIT?

17 A. The consecutive years of a NOL have been primarily due to the continual extension of
18 the federal economic incentive allowing for additional bonus depreciation deductions
19 over that period. A federal NOL can be carried back two years, and forward 20 years.
20 Since MERC and Integrys have incurred NOLs during 2012 and 2013 greater than the
21 taxable income generated in 2010 and 2011 (the 2 year carryback period), MERC is in
22 the position of carrying forward the NOL.

23

1 Q. WHAT IS BONUS DEPRECIATION AND WHAT IS ITS PURPOSE?

2 A. Bonus depreciation is an acceleration of tax depreciation deductions to the first year
3 qualified property goes in service. The acceleration is based on a set percentage of the
4 tax basis of the qualified property. Congress enacted the bonus depreciation provision in
5 an effort to stimulate investment and create jobs at various times and at various levels
6 over the past decade. Bonus depreciation has allowed MERC to offset rate base and has
7 kept rates lower than they otherwise would have been.

8

9 Q. FOR TAX PURPOSES, WHAT HAPPENS WHEN A UTILITY HAS MORE
10 DEDUCTIONS, INCLUDING ACCELERATED DEPRECIATION AND BONUS
11 DEPRECIATION, THAN IT HAS INCOME?

12 A. If a utility has more tax deductions than taxable income in a given tax year, it has a tax
13 NOL.

14

15 Q. HOW CAN A NOL BE USED?

16 A. As I explained earlier in my Testimony, for federal tax purposes NOLs can be carried
17 back and applied against taxable income (if any) in the two prior years. Then any
18 remaining unused NOL is carried forward until utilized for up to 20 years. The
19 determination if a standalone entity can carry a loss back or forward to be benefited is
20 subject to the consolidated group of company's taxable income position in the applicable
21 carryback and carryforward period.

22

23 Q. WHAT IS THE STATUS OF INTEGRYS' NOL POSITION FOR 2012

1 AND 2013?

2 A. Integrys will generate an NOL in both 2012 and 2013, for the same
3 primary reason MERC is generating an NOL during those years. As a result taking
4 advantage of bonus depreciation for several years, the Integrys consolidated group will
5 also be in a NOL carryforward position for 2012 and 2013.

6

7 Q. WHAT IS THE STATUS OF INTEGRYS' NOL POSITION FOR 2014?

8 A. For 2014, Integrys consolidated is assumed to be in an income position sufficient to
9 absorb the NOL carryforward from 2012 and 2013. Therefore in 2014, MERC's NOL
10 deferred tax asset ("DTA") will be currently settled and will reverse over the course of
11 the year.

12

13 Q. IF A DTA IS NOT INCLUDED IN RATE BASE, WHAT IS THE RESULT?

14 A. MERC would be in violation of the tax normalization rules.

15

16 Q. PLEASE EXPLAIN THE SPECIFIC TAX NORMALIZATION RULE THAT
17 RELATES TO A NOL.

18 A. The normalization rules related to a federal NOL can be summarized as a requirement
19 that the utility has to have realized the tax cash flow benefit of claiming accelerated
20 depreciation before the deferred tax liability that results from claiming accelerated
21 depreciation is included in rate base. Therefore, the tax normalization rules require
22 MERC to carry a deferred tax asset for the NOL balance from 2012 and 2013 that
23 resulted from claiming accelerated tax depreciation, until used during 2014. An example

1 of MERC NOL situation and the IRS findings in that case can be found in Private Letter
2 Ruling (“PLR”) 8818040. In that ruling, the taxpayer did not realize the entire tax benefit
3 from the ACRS [Accelerated Cost Recovery System] depreciation claimed in 1985 and
4 1986 because the depreciation resulted in a NOL carryover to 1987. Therefore, in order
5 to reflect the tax benefit of the NOL carryover to 1987, the taxpayer reduced their
6 deferred federal income tax expense and liability for 1985 and 1986 for financial
7 reporting purposes. The IRS found this action consistent with the federal tax code.
8 MERC likewise must carry a deferred tax asset until it is used in 2014.

9
10 Q. WILL INCLUDING THE DTA IN RATE BASE IN THIS PROCEEDING BE AKIN TO
11 WHAT OCCURRED IN THIS CIRCUMSTANCE AS DESCRIBED IN THE PLR?

12 A. Yes, it would. Recording the effects of a NOL as a DTA is the modern day equivalent of
13 the reduction in deferred tax liability in the ruling. By including the DTA related to the
14 NOL, the tax benefit recorded in the deferred tax liability related to accelerated
15 depreciation is effectively eliminated until such time as the loss is realized.

16
17 Q. WHAT EFFECT WOULD A NORMALIZATION VIOLATION HAVE ON
18 CUSTOMERS?

19 A. A violation of the normalization rules would create severe detriment for both
20 MERC and its customers. The normalization rules are long-standing and Congress has
21 been unwavering in its mandate. These rules have been in force and the impact of
22 noncompliance has been known to utilities and their regulators for the past four decades.
23 Compliance with these rules is not optional and cannot be violated directly or indirectly.

1 Thus, it is important not to take steps that would have the unintended consequence of
2 losing the ability to continue to claim the rate base reducing impacts of accelerated and
3 bonus depreciation purposes.

4

5 Q. ALTHOUGH INTEGRYS IS CURRENTLY FORECASTING AN NOL POSITION IN
6 2014, WHAT WOULD MERC AND THE COMMISSION BE REQUIRED TO DO IF
7 THE FINAL RATE RELIEF IN THE INSTANT RATE CASE RESULTED IN A NOL
8 FOR MERC AND INTEGRYS CONSOLIDATED?

9 A. If both MERC's operating income and Integrys' consolidated forecasted tax positions
10 project a federal NOL, an increase to the NOL DTA must be computed and added to rate
11 base.

12

1 **III. HEALTH CARE REFORM LEGISLATION**

2 Q. IN MERC’S PRIOR RATE CASE DOCKET NO. G007, 011/GR-10-977, YOU
3 DESCRIBED THE RE-MEASUREMENT OF DEFERRED TAX BALANCES
4 CAUSED BY ENACTMENT OF HEALTH CARE REFORM LEGISLATION IN 2010.

5 A. Yes, I did.
6

7 Q. WHAT WAS THE RESULT OF THE PRIOR RATE CASE DOCKET?

8 A. The Department recommended deferral of the Medicare Part D subsidy decision making
9 until MERC’s next rate case and MERC agreed to that request.
10

11 Q. PLEASE DESCRIBE MERC’S PROPOSED REGULATORY ACCOUNTING FOR
12 THE RE-MEASUREMENT OF DEFERRED TAX BALANCES CAUSED BY
13 ENACTMENT OF HEALTH CARE REFORM LEGISLATION IN 2010.

14 A. MERC proposes to account for this change in tax law, and the resulting effects on its
15 deferred tax balances, following the principles of full normalization and using the
16 average rate assumption method (“ARAM”), effective with the enactment date of 2010
17 federal health care legislation. Applying the principles of full normalization and using
18 ARAM would result in the re-measurement of deferred taxes for the change in tax law
19 being offset by a regulatory deferral. Both the resulting deferred tax balance and the
20 offsetting regulatory deferral would be normalized through the provision for income
21 taxes used to determine MERC’s rates starting in 2013, when the new law takes effect,
22 and continuing over the time period that the accrued benefit expenses for post retirement
23 prescription drug charges are actually incurred.

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Q. DOES MERC REQUEST COMMISSION APPROVAL OF MERC’S PROPOSED REGULATORY ACCOUNTING FOR THE RE-MEASUREMENT OF DEFERRED TAX BALANCES CAUSED BY ENACTMENT OF HEALTH CARE REFORM LEGISLATION IN 2010, AS DESCRIBED ABOVE?

A. Yes, we do. Based on MERC’s review of Securities and Exchange Commission, documents filed by other Minnesota utilities or their parent corporations, MERC understands this is accepted practice in Minnesota. It is also consistent with the past practice of other Integrys utilities. Further, this proposal will benefit MERC’s customers, as it reduces MERC’s costs in the 2014 proposed test year. The alternative would be for MERC to “flow-through” these costs and recognize any benefits in 2013, which would solely benefit MERC’s shareholder.

1 **IV. UPDATE OF MERC'S 2011-2012 PROPERTY TAX OBLIGATIONS**

2 Q. IN MERC'S PRIOR RATE CASE DOCKET NO. G007, 011/GR-10-977, YOU
3 INDICATED THAT MERC'S PROPERTY ASSESSMENTS HAD DRAMATICALLY
4 INCREASED BEGINNING WITH 2010. YOU FURTHER INDICATED THAT THIS
5 RESULTED IN SIGNIFICANT INCREASES IN 2010 AND 2011 PROPERTY TAX
6 AMOUNTS. DID YOU PROTEST THESE INCREASES?

7 A. Yes, as indicated in my prior rate case testimony we did experience these increases and
8 we did protest them.

9
10 Q. WHAT WAS THE OUTCOME OF THESE PROTESTS?

11 A. MERC has formally appealed the property tax assessments for years 2008-2013. None of
12 the years appealed were resolved through the administrative process, and MERC is now
13 pursuing a resolution through Minnesota Tax Court. The case is ongoing and has not
14 concluded.

15
16 MERC is still unable to predict an outcome of those protests at this time. Pending a
17 resolution of those protests, MERC will be obligated to pay its property tax obligations
18 based on the increased property value assessments.

1 **V. MERC'S 2014 PROPERTY TAX OBLIGATIONS**

2 Q. PLEASE EXPLAIN MERC'S 2014 PROPERTY TAX OBLIGATIONS.

3 A. MERC is filing the instant general rate case proceeding with an estimated property tax
4 expense of \$7,314,733 for the 2014 test year, inclusive of \$375,000 of tax associated with
5 storage gas. The \$7,314,733 value represents an inflationary increase in MERC's
6 Minnesota property tax expense consistent with what MERC has been experiencing over
7 the past several years.

8
9 Q. ARE YOU SPONSORING ANY EXHIBITS WITH YOUR DIRECT TESTIMONY?

10 A. Yes, I am. I am sponsoring one exhibit, Exhibit ____ (JRW-1), which is a calculation of
11 MERC's estimated 2013-2014 property tax obligations by taxing authority.

12
13 Q. PLEASE SUMMARIZE THE RESULTS SHOWN ON EXHIBIT ____ (JRW-1).

14 A. MERC's Minnesota estimated property tax expenses will be approximately \$7,314,733 in
15 2014, an increase of \$712,679 from the 2012 historic test year.

VI. CONCLUSION

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2 Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

3 A. Yes, it does.

Property Taxes
 2013-2015 Estimated Payments
 (2012-2014 Estimated Expense)
Minnesota Energy Resources Corporation
Property Tax Estimate 2013-2014

Line	County	Muni Type	Muni Name	Parcel	2012 Assessed Value	2012 Taxes	2013 Assessed Value	2013 Est. Taxes
1	Centrally and Locally Assessed Property	All	All	All	161,791,700	6,018,068.78	167,088,500	6,248,900.00
2								
3							MI PPT	133
4							KS Storage Gas	375,000
5							2013 Total Pmt	6,624,033
6								
7							2013 Inflation	5.08%
8							MN Total	6,960,821
9								
10							2014 Inflation	5.08%
11							MN Total	7,314,733