

**EXH. MRM-4  
DOCKETS UE-22 \_\_\_/UG-22 \_\_\_  
2022 PSE GENERAL RATE CASE  
WITNESS: MATTHEW R. MARCELIA**

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,**

**Complainant,**

**v.**

**PUGET SOUND ENERGY,**

**Respondent.**

**Docket UE-22 \_\_\_  
Docket UG-22 \_\_\_**

**THIRD EXHIBIT (NONCONFIDENTIAL) TO THE  
PREFILED DIRECT TESTIMONY OF**

**MATTHEW R. MARCELIA**

**ON BEHALF OF PUGET SOUND ENERGY**

**JANUARY 31, 2022**

**EXH. MRM-1Tr  
DOCKETS UE-190529/UG-190530  
UE-190274/UG-190275  
2019 PSE GENERAL RATE CASE  
WITNESS: MATTHEW R. MARCELIA**

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,**

**Complainant,**

**v.**

**PUGET SOUND ENERGY,**

**Respondent.**

**Docket UE-190529  
Docket UG-190530 (*Consolidated*)**

**In the Matter of the Petition of**

**PUGET SOUND ENERGY**

**For an Order Authorizing Deferral  
Accounting and Ratemaking Treatment  
for Short-life IT/Technology Investment**

**Docket UE-190274  
Docket UG-190275 (*Consolidated*)**

**PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF**

**MATTHEW R. MARCELIA**

**ON BEHALF OF PUGET SOUND ENERGY**

**REVISED  
JANUARY 29, 2020**

**JANUARY 15, 2020**

1 customers no more quickly than over the remaining book life of the underlying  
2 assets. Additionally, all of the following items must be treated consistently:  
3 depreciation expense, tax expense (including deferred tax expense, of which  
4 EDIT is a subcomponent), accumulated deferred taxes on the balance sheet, and  
5 rate base. This will allow PSE to comply with the consistency rule as discussed  
6 later in my testimony.

7 **D. Normalization of plant related EDIT**

8 **1. In General**

9 **Q. Please provide an overview of the tax normalization rules.**

10 A. The normalization requirements of the Internal Revenue Code are designed to  
11 prohibit the direct or indirect flow-through of accelerated depreciation tax benefits  
12 to utility customers. The requirements generally mandate the use of a  
13 “normalization method of accounting.”<sup>1</sup> The tax laws require certain plant related  
14 book/tax timing differences to be normalized. When something is normalized for  
15 tax purposes, it means that the deferred tax is recorded on the balance sheet and is  
16 factored into the utility’s ratemaking.

17 The normalization requirements were added to the Internal Revenue Code by  
18 Congress with the Tax Reform Act of 1969. The normalization rules were enacted  
19 in response to concern over the impact on federal revenues from the growing  
20 trend towards the “flow-through” of accelerated depreciation tax benefits to

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<sup>1</sup> IRC §168(i)(9)(A).

1 ratepayers. Before normalization, the tax benefits of accelerated depreciation  
2 could be passed from the utility to ratepayers (i.e., flowed through) by reducing  
3 the federal income tax expense component of cost of service for the accelerated  
4 tax depreciation deductions. The reduced cost of service, in turn, lowered the  
5 revenue requirements for the utility. Therefore, the tax benefits were not retained  
6 by the utility but, instead, were flowed through to ratepayers in the form of lower  
7 utility rates. In addition, Congress was concerned about the “double loss” of tax  
8 revenue: first, when the utility claimed the accelerated tax deductions; and  
9 second, when it received lower tax revenue from regulated utility companies. The  
10 combined effect results in the utility’s taxable income being lowered twice for the  
11 same tax benefit.

12 A regulated utility is considered to use a normalization method of accounting for  
13 public utility property if: (1) it uses the same depreciation method and a  
14 depreciation period no shorter than the method and period used for purposes of  
15 determining depreciation expense for cost of service and (2) any variation in the  
16 federal income tax expense attributable to use of a method of depreciation for  
17 ratemaking purposes different from the method used for federal income tax  
18 purposes must be adjusted to a reserve account (i.e., credited or debited to a  
19 deferred tax asset or liability account). The reserve balance attributable to this  
20 adjustment may be treated as a reduction from the rate base or as zero-cost  
21 capital.

**EXH. DAD-7T  
DOCKETS UE-190529/UG-190530  
UE-190274/UG-190275  
2019 PSE GENERAL RATE CASE  
WITNESS: DANIEL A. DOYLE**

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,**

**Complainant,**

**v.**

**PUGET SOUND ENERGY,**

**Respondent.**

**Docket UE-190529  
Docket UG-190530 (*Consolidated*)**

**In the Matter of the Petition of**

**PUGET SOUND ENERGY**

**For an Order Authorizing Deferral  
Accounting and Ratemaking Treatment  
for Short-life IT/Technology Investment**

**Docket UE-190274  
Docket UG-190275 (*Consolidated*)**

**PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF**

**DANIEL A. DOYLE**

**ON BEHALF OF PUGET SOUND ENERGY**

**JANUARY 15, 2020**

1 **Q. How does PSE respond to these proposals?**

2 A. Before proceeding, it might be useful to briefly summarize why the normalization  
3 rules exist in the first place. In 1954, Congress passed tax legislation that allowed  
4 for the use of accelerated depreciation for tax purposes as a means of stimulating  
5 corporate capital investment and the U.S. economy. Over the next 15 years, both  
6 the IRS and Congress closely monitored the extent to which both utilities and  
7 their regulators adopted the practice of passing back the benefit of accelerated  
8 depreciation immediately in rates, otherwise known as “flow-accounting”. Over  
9 that 15-year period, both Congress and the IRS recognized and became  
10 increasingly alarmed by the pervasive adoption of flow-through accounting in the  
11 utility sector, which had created a substantial and unintended consequence (from  
12 allowing accelerated depreciation in 1954) in the form of a substantial “transfer  
13 payment” of tax liability from utilities to all other U.S. taxpayers.

14 The use of flow-through accounting reduced tax revenues in the utility sector (i.e.,  
15 lower current tax expense due to accelerated depreciation results in lower utility  
16 rates to customers and less taxable revenue to the IRS) and those reduced tax  
17 revenues would have to be collected from other U.S. taxpayers, all else being  
18 equal, for the government to pay its bills. Given the capital-intensive nature of the  
19 utility industry (recall that as the 1970s approached, the permitting, siting, and  
20 construction of expensive nuclear generating facilities became in vogue), the IRS  
21 realized that the resulting transfer payments referenced above could become  
22 increasingly significant, harmful, and unfair to non-utility U.S. taxpayers and was  
23 simply not sustainable tax policy.

1 From this analysis and the obvious tax equity considerations, the IRS  
2 normalization rules were born, and, in the first instance, prohibited the use of  
3 flow-through accounting by utilities in connection with the adoption or continued  
4 use of accelerated depreciation for tax purposes. Further, the normalization rules  
5 also govern the inclusion deferred tax expense related to the use of accelerated  
6 depreciation in rates and also the reversal of accumulated deferred taxes in rates  
7 over the remaining book lives of assets, after those assets become fully  
8 depreciated for tax purposes. The ARAM rules build off of this latter concept.  
9 That is, to the extent that tax reform (reduction in tax rates) creates EDIT, those  
10 EDIT are passed back to customers ratably over the remaining book lives of the  
11 corresponding assets at the time they become fully depreciated for tax purposes.  
12 Importantly, this treatment mandates the reversal of accumulated deferred income  
13 taxes, EDIT included, over the same timeframe and in the same amounts had tax  
14 reform (reduction in tax rates) never occurred in the first place.

15 In the final analysis, the IRS normalization rules exist to prevent unintended  
16 consequences in the form of transfer payments from utility taxpayers to all other  
17 U.S. taxpayers, and actively prevent both utilities and their commissions from  
18 creating those transfer payments, by (1) eliminating flow-through accounting in  
19 all of its forms and permutations and (2) requiring the very specific application of  
20 the accounting and ratemaking protocols that comprise the normalization rules.

21 With this background, PSE fundamentally disagrees regarding the interpretation  
22 and proper application of the applicable IRS normalization rules. Further, as  
23 discussed below, neither customers nor the IRS have been harmed by PSE's

1 amortization of protected EDIT, and no refunds of these amounts are appropriate  
2 or required.

3 The Prefiled Direct Testimony of PSE witness Matthew R. Marcellia, Exh. MRM-  
4 1T, provides a detailed discussion of the IRS normalization rules, and the  
5 applicable components of the rules germane to this discussion are as follows:

- 6 1. The reversal of protected EDIT under the ARAM construct  
7 must begin on the effective date of tax reform for those  
8 vintages of property that have been fully depreciated for tax  
9 purposes.
- 10 2. Whenever the reversal of protected EDIT are included in  
11 rates as a cash refund to customers, the consistency  
12 requirements embedded in the IRS normalization rules  
13 require that base rates be updated to synchronize  
14 depreciation expense, current and deferred tax expense,  
15 accumulated deferred income tax balances including EDIT,  
16 and rate base.

17 **Q. Did PSE begin the reversal of protected deferred taxes on the effective date**  
18 **of tax reform for those vintages of property that were fully depreciated for**  
19 **tax purposes at the time?**

20 A. Yes. PSE began the reversal of protected deferred taxes on the effective date of  
21 tax reform for those vintages of property that were fully depreciated for tax  
22 purposes at the time. PSE properly amortized approximately \$34.1 million of  
23 EDIT during the period January 2018 through February 28, 2019. The  
24 amortization of protected EDIT during that period related to all vintages of  
25 protected property that were or became fully depreciated for tax purposes. This is  
26 the proper ARAM accounting treatment until and when all components of the