BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

THIRD EXHIBIT (NONCONFIDENTIAL) TO THE
PREFILED DIRECT TESTIMONY OF

MATTHEW R. MARCELIA

ON BEHALF OF PUGET SOUND ENERGY

JANUARY 31, 2022
BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

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-190529
Docket UG-190530 (Consolidated)

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
customers no more quickly than over the remaining book life of the underlying assets. Additionally, all of the following items must be treated consistently:

depreciation expense, tax expense (including deferred tax expense, of which EDIT is a subcomponent), accumulated deferred taxes on the balance sheet, and rate base. This will allow PSE to comply with the consistency rule as discussed later in my testimony.

D. Normalization of plant related EDIT

1. In General

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

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

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

1 IRC §168(i)(9)(A).
ratepayers. Before normalization, the tax benefits of accelerated depreciation could be passed from the utility to ratepayers (i.e., flowed through) by reducing the federal income tax expense component of cost of service for the accelerated tax depreciation deductions. The reduced cost of service, in turn, lowered the revenue requirements for the utility. Therefore, the tax benefits were not retained by the utility but, instead, were flowed through to ratepayers in the form of lower utility rates. In addition, Congress was concerned about the “double loss” of tax revenue: first, when the utility claimed the accelerated tax deductions; and second, when it received lower tax revenue from regulated utility companies. The combined effect results in the utility’s taxable income being lowered twice for the same tax benefit.

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

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PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF

DANIEL A. DOYLE

ON BEHALF OF PUGET SOUND ENERGY

JANUARY 15, 2020
Q. How does PSE respond to these proposals?

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

The use of flow-through accounting reduced tax revenues in the utility sector (i.e., lower current tax expense due to accelerated depreciation results in lower utility rates to customers and less taxable revenue to the IRS) and those reduced tax revenues would have to be collected from other U.S. taxpayers, all else being equal, for the government to pay its bills. Given the capital-intensive nature of the utility industry (recall that as the 1970s approached, the permitting, siting, and construction of expensive nuclear generating facilities became in vogue), the IRS realized that the resulting transfer payments referenced above could become increasingly significant, harmful, and unfair to non-utility U.S. taxpayers and was simply not sustainable tax policy.
From this analysis and the obvious tax equity considerations, the IRS normalization rules were born, and, in the first instance, prohibited the use of flow-through accounting by utilities in connection with the adoption or continued use of accelerated depreciation for tax purposes. Further, the normalization rules also govern the inclusion deferred tax expense related to the use of accelerated depreciation in rates and also the reversal of accumulated deferred taxes in rates over the remaining book lives of assets, after those assets become fully depreciated for tax purposes. The ARAM rules build off of this latter concept. That is, to the extent that tax reform (reduction in tax rates) creates EDIT, those EDIT are passed back to customers ratably over the remaining book lives of the corresponding assets at the time they become fully depreciated for tax purposes. Importantly, this treatment mandates the reversal of accumulated deferred income taxes, EDIT included, over the same timeframe and in the same amounts had tax reform (reduction in tax rates) never occurred in the first place.

In the final analysis, the IRS normalization rules exist to prevent unintended consequences in the form of transfer payments from utility taxpayers to all other U.S. taxpayers, and actively prevent both utilities and their commissions from creating those transfer payments, by (1) eliminating flow-through accounting in all of its forms and permutations and (2) requiring the very specific application of the accounting and ratemaking protocols that comprise the normalization rules. With this background, PSE fundamentally disagrees regarding the interpretation and proper application of the applicable IRS normalization rules. Further, as discussed below, neither customers nor the IRS have been harmed by PSE’s
amortization of protected EDIT, and no refunds of these amounts are appropriate or required.

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

1. The reversal of protected EDIT under the ARAM construct must begin on the effective date of tax reform for those vintages of property that have been fully depreciated for tax purposes.

2. Whenever the reversal of protected EDIT are included in rates as a cash refund to customers, the consistency requirements embedded in the IRS normalization rules require that base rates be updated to synchronize depreciation expense, current and deferred tax expense, accumulated deferred income tax balances including EDIT, and rate base.

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

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