



OPPONENT TESTIMONY

Senate Bill 126

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Senate Committee on Utilities
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Good afternoon Chairman Masterson and members of the committee. Thank you for the opportunity to present testimony in opposition to Senate Bill 126 on behalf of Kansas Gas Service; the state's largest regulated natural gas utility serving more than 635,000 commercial, industrial and residential customers in 341 communities across Kansas. My name is Janet Buchanan and I am Director of Rates and Regulatory Reporting.

Kansas Gas Service appreciates the opportunity to share its concerns raised by Senate Bill 126 and why it believes the proposed bill is unnecessary. The bill as drafted:

- could cause a violation of Internal Revenue Service (IRS) normalization rules; which would result in increasing rates to customers;
- imposes a requirement to implement a rate reduction at an unreasonable pace;
- could result in multiple rate cases in one year;
- lacks symmetry; and
- could negatively impact certain deferred tax benefits that have been accrued for a utility's customers, which would result in increasing rates to customers.

I. VIOLATION OF IRS NORMALIZATION RULES

Senate Bill 126 defines overcollection of income tax expense as “. . . the portion of utility revenue representing the difference between the cost of service as approved by the state corporation commission in the utility's most recent base rate proceeding and the cost of service that would have resulted had the provision for state or federal income taxes been based upon the

reduced corporate income tax rate.” It is unclear whether this includes the effect of the change in income tax expense on a utility’s accumulated deferred income taxes. If such impact is included, then the required treatment of excess deferred income tax will create a violation of the Internal Revenue Service’s normalization rules. Normalization is a set of accounting rules within the Internal Revenue Code used by regulated utilities to reconcile the tax treatment of accelerated depreciation of utility assets with their regulatory treatment. If a utility is found to have violated normalization rules, it would be required to pay existing deferred taxes to the government over a much shorter period than the life of the property, plant and equipment which is the expected time-period. Additionally, the utility would no longer be eligible to utilize accelerated depreciation for tax purposes in the future which would eliminate the related deferred tax liabilities that reduce rate base. The consequences to a normalization violation would ultimately result in significantly higher rates for its customers.

II. 30-DAY IMPLEMENTATION PERIOD IS TOO SHORT

The bill requires new rates to be implemented within 30 days of a change in state or federal corporate income tax rates. While we understand the desire to distribute the benefits of a reduction in income tax expense to utility customers as quickly as possible, based on recent experience, this bill imposes a pace that is impossible for Kansas Gas Service to meet. The Tax Reform and Jobs Act (TCJA) was enacted on December 22, 2017, and reduced the federal corporate income tax rate from 35% to 21%. The Kansas Corporation Commission (Commission) issued an order on May 15, 2018, requiring Kansas Gas Service to defer the difference (reduction) between: (1) the cost of service as approved by the Commission in its most recent rate case; and (2) the cost of service that would have resulted had the provision for federal income taxes been based upon the corporate income tax rate approved in the TCJA. Given the demands placed on the Commission to conduct an evaluation for each utility, the deferral associated with the reduction in the cost of service for Kansas Gas Service was not approved until five months following the passage of the TCJA. Thus, it would not have been feasible to reduce rates within 30 days of the change in the tax rate. This deferral was then addressed in the Company’s general rate proceeding which culminated with an order on February 25, 2019.

Additionally, there are often nuances to tax legislation, other than the change in the tax rate, that can affect utility rates. It is common for additional guidance to be issued after enactment that could have a significant impact on the regulatory treatment of taxes. For example, in the TCJA, companies are no longer allowed to deduct employee parking expenses as business expenses in determining taxable income. The IRS is still working on guidance for tax preparers on how to apply this guidance to company-owned facilities that include parking. The loss of this deduction will ultimately cause the amount of taxes incurred by the company and included in the cost of service to increase. This bill does not provide a mechanism or remedy for the application of that new guidance on utility rates after the 30-day period

III. MULTIPLE RATE CHANGES

As mentioned above, the treatment of the TCJA tax reform was addressed within a rate case filed by Kansas Gas Service. In the recently completed rate case, it was shown that the Company was not earning its authorized rate of return even with the reduction in the corporate income tax rate and was therefore providing utility service at rates subsidized by Company shareholders. The Commission approved increased rates, to allow Kansas Gas Service the opportunity to recover its reasonable and necessary costs of providing service inclusive of the lower (21%) federal income tax rate. Thus, even if reduced rates could have been implemented within 30 days of passage of the TCJA as contemplated by this bill, customers would have experienced multiple rate adjustments within a 12-month period when the Commission subsequently approved a rate increase for the Company (as identified within this example). The fluctuation in bills down and then up caused by multiple rate changes in a relatively short period of time would create customer confusion. This confusion is especially pronounced when a rate decrease is followed by an increase in rates.

IV. LACKING IN SYMMETRY

While Senate Bill 126 contemplates reductions in the corporate income tax rate, it does not address increases in the tax rate. It is reasonable to amend the language of this bill to apply to changes (increases or decreases) in the tax rate so that neither the customer nor the utility is unfairly disadvantaged by a change in the tax rate.

V. NEGATIVE IMPACT ON DEFERRED TAX BENEFITS TO CUSTOMERS

Senate Bill 126 also makes utilities exempt from Kansas income taxes for the tax years 2019 through 2022. This will reduce the level of income taxes collected by a utility from its customers; however, there could be effects of this exemption that increase the costs to customers. If a utility has Kansas net operating loss carryforwards that expire during this exemption period or shortly thereafter, absent some form of statutory or regulatory relief, it would be likely that the utility would not be able to utilize these carryforwards. This would result in the elimination of a deferred tax benefit that had accrued for the benefit of our customers. The elimination of the deferred tax benefit would trigger a write off of the corresponding deferred tax asset and result in an increase in a utility's cost of service.

VI. CONCLUSION

Each of the concerns mentioned in my testimony can best be addressed by the Commission without making any changes to the current law and allowing the Commission to utilize its current authority to assure customers receive the benefits of any tax law changes. This was certainly demonstrated by the recent actions taken by the Commission in assuring the tax benefits relating to the recent TCJA were passed on to customers in a reasonable manner and time frame while effectively considering and addressing each of the above-mentioned concerns.

Thank you for your consideration of these comments in opposition to Senate Bill 126. I will be available for questions at the appropriate time.