

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

OFFICIAL  
EXHIBITS

IN THE MATTER OF THE INDIANA )  
UTILITY REGULATORY COMMISSION'S )  
INVESTIGATION INTO THE IMPACTS OF )  
THE TAX CUTS AND JOBS ACT OF 2017 )  
AND POSSIBLE RATE IMPLICATIONS )  
UNDER PHASE 2 FOR INDIANA- )  
AMERICAN WATER COMPANY, INC. )

CAUSE NO. 45032 S4

RESPONSE OF INDIANA-AMERICAN WATER COMPANY, INC.  
TO NOVEMBER 28, 2018 DOCKET ENTRY

Respondent Indiana-American Water Company, Inc. ("Respondent," the "Company," or "Indiana-American"), pursuant to the Docket Entry of November 28, 2018 in the above-captioned Subdocket, respectfully submits its responses to the questions set forth in the Docket Entry.

1. Do the Parties believe the adoption of Indiana-American's estimated excess accumulated deferred income tax would violate IRS normalization rules if it were subject to true up upon completion of American Water's implementation of its software to align and configure its data for compliance with ARAM early next year? Please explain.

No, with the following clarification. Indiana-American continues to believe that adoption of estimated excess accumulated deferred income taxes ("ADIT") balances or estimated amortization periods that are created in a manner not consistent with the balances and amortization periods produced by application of the average rate assumption method ("ARAM") required by federal normalization requirements would expose the Company and its customers to substantial risk of incurring the severe penalties for violations of those requirements. Indiana-American believes the best way to insure compliance with the income tax normalization rules, which safeguards the interests of both the Company and its customers, is to let Indiana-American complete its system implementation prior to the refund of any plant-related excess ADIT. As

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discussed below there are significant uncertainties that exist related to accounting and ratemaking for excess ADIT, including the fact that the IRS has not yet issued detailed guidance related to refund of plant-related excess ADIT.<sup>1</sup>

Indiana-American believes the following statutory requirement would apply to any method of estimating and normalizing “protected” excess ADIT in a cost of service rate setting proceeding:

A normalization method of accounting shall not be treated as being used with respect to any public utility property for purposes of section 167 or 168 of the Internal Revenue Code of 1986 if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method.

Tax Cuts and Jobs Act of 2017, Pub. Law 115-97, §12001(d)(1). Indiana-American also believes the following requirement taken from a consent decree it has with the IRS would apply to any method of estimating and refunding excess accumulated deferred income taxes in a cost of service rate setting proceeding:

9) If any item of property subject to the taxpayer’s Form 3115 is public utility property within the meaning of §168(i)(10) or former §167(I)(3)(A):

(A) A normalization method of accounting (within the meaning of § 168(i)(9), former § 168(e)(3)(B), or former §167(I)(3)(G), as applicable) must be used for such public utility property.

It is possible that an estimated ARAM calculation done in accordance with the tax normalization rules of the Tax Cuts and Jobs Act and the Internal Revenue Code, including the

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<sup>1</sup> On November 8, 2018, the IRS announced that it intends to issue guidance addressing excess deferred income taxes and public utility companies. See Office of Tax Policy and Internal Revenue Service, “2018-2019 Priority Guidance Plan,” at 4 (item 11) (Nov. 8, 2018), available at [https://www.irs.gov/pub/irs-utl/2018-2019\\_pgp\\_initial.pdf](https://www.irs.gov/pub/irs-utl/2018-2019_pgp_initial.pdf) (accessed Nov. 30, 2018). The forthcoming IRS guidance is expected to address characterization of specific basis differences as subject to or not subject to the normalization requirements.

consistency requirement, could be used in a cost of service rate setting proceeding and satisfy both the statutory requirement and the condition in the consent decree cited above. Indiana-American believes an estimated true up provision or reconciliation to a later and more robust ARAM calculation does further support conformity with both the cited statutory requirement and the condition set forth in the consent decree. Nevertheless, Indiana-American continues to believe that the estimated ARAM calculation it plans to provide to the Commission during the second quarter of 2019 using the industry standard software tool PowerTax would be the best way to mitigate risk in terms of being considered to have violated the statutory requirements and the condition set forth in the consent decree.

Absent the Commission permitting Indiana-American until the second quarter of 2019 to complete its 2018 ARAM computation, Indiana-American believes it could make and utilize an estimate of the normalization of the estimated plant related excess ADIT balances that have been provided and do so pursuant to ARAM before year-end using, for example, a spreadsheet model that is closely enough aligned with ARAM as to be an estimate that, subject to true-up, could satisfy the above mentioned requirements. (If the Commission wishes the Company to bifurcate plant related excess ADIT balances into those subject to the above cited requirements where ARAM would be mandatory, and those that could be refunded using an alternative approach that could delay the estimate by a month or more.) However, while this course might pass IRS muster, it still subjects Indiana-American and its customers to greater risk of being held to have violated the normalization rules than allowing the Company the time to complete its 2018 ARAM calculation. Given that the timing difference is only four or five months, Indiana-American continues to believe that completion of its ARAM calculation before returning excess ADIT is the more prudent course, and the one that best protects the interests of its customers.

Finally, any proposal that uses estimates or amortization periods that have been calculated in a manner inconsistent with ARAM should be rejected as posing an unacceptable risk of a normalization violation.

**2. Please provide estimated amounts and amortization periods for the following:**

- A. Protected Plant-Related Assets.**
- B. Unprotected Plant-Related Assets.**
- C. Unprotected Non-Plant Assets.**

Indiana-American has provided the commission with estimated non-plant related excess ADIT balances and plant related excess ADIT balances (Attachment JRW-1). Indiana-American has not provided an ARAM estimated normalization amount for any year for its estimated plant related excess ADIT balances, nor could the estimates provided alone be used to compute an ARAM estimated normalization amount. As of December 31, 2017, the Company's estimated protected plant related excess ADIT was \$71,378, 974 (a deferred tax liability), and its estimated unprotected non-plant excess ADIT was (\$305,118) (a deferred tax asset). Having filed the 2017 tax return in October, the updated estimates based on the return as filed are in the process of being revised and will be used for December 31, 2018 financial accounting and reporting purposes. Using updated estimates of excess ADIT balances would provide greater certainty that those balances were developed consistent with the tax normalization rules, and could be more easily be aligned in a normalization computation pursuant to ARAM. Also, using updated estimates that would be available shortly would provide a closer alignment with the actual results as ultimately produced in a robust ARAM estimation process should also reduce the amount of true-up that needs to be address in future rate setting.

Indiana-American only has estimates of excess ADIT available for protected plant related assets and un-protected non-plant assets – it does not have an estimate of the split between

protected and unprotected plant related assets. Prior to the enactment of the Tax Cuts and Jobs Act, its systems and the data structure in those systems was established to use the Reverse South Georgia Method as its method of accounting for normalized deferred taxes including excess deferred that resulted from prior tax law changes. Isolating out the balances of protected plant related excess ADIT balances and non-protected is a complex and time consuming process. While the data exists to do so, it has to be gathered, analyzed, and accurately put into a common structure in order for the software to then estimate the normalization of the balances pursuant to ARAM. In addition, until the IRS issues guidance to clarify which components of the excess ADIT balances should be treated as protected or unprotected, uncertainty will exist related to compliance with or violation of the normalization rules. While some parties to this proceeding believe there is a bright-line distinction drawn in the Code between what should be considered as protected or not pursuant to the tax normalization, Indiana-American does not believe that to be the case, and expects to see guidance issued by the IRS to clarify its position on the subject as indicated in the IRS's recent announcement.<sup>2</sup>

With respect to amortization, excess ADIT balances resulting from the Tax Cuts and Jobs Act will reverse over the remaining life of the tax class life property. The Company has estimated the composite remaining life of Indiana-American property to be 41.49 years, which is the period in which Indiana-American would expect the majority of excess ADIT balances would reverse using ARAM. However, ARAM as a method does not yield a single period over which the amortization will occur. Property associated with each tax guideline class and vintage will have a different remaining life and vintage, and ARAM will reverse only when the relevant book to tax

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<sup>2</sup> As noted above, on November 8, 2018, the IRS announced it plans to provide "Guidance under [Internal Revenue Code] §§168(f)(2) and (i)(9) addressing excess deferred income taxes and public utility companies." Office of Tax Policy and Internal Revenue Service, "2018-2019 Priority Guidance Plan," at 4 (item 11) (Nov. 8, 2018), *available at* [https://www.irs.gov/pub/irs-utl/2018-2019\\_pgp\\_initial.pdf](https://www.irs.gov/pub/irs-utl/2018-2019_pgp_initial.pdf) (accessed Nov. 30, 2018).

differences for that guideline class and vintage begin to reverse. So, for example, an ARAM calculation will yield guideline class vintage combinations that will reverse in 1 year, and guideline class vintage combination that will not start reversing for over 12 years and will not finish normalizing excess for over the longest book life. Therefore, for any utility the remaining useful life that ARAM will be reversing is the longest book life associated with plant.

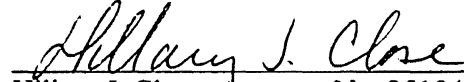
**3. Regarding Protected Plant-Related Assets, do the Parties believe the adoption of the estimated amortization period for protected plant-related assets would violate IRS normalization rules if it were subject to true up upon completion of American Water's implementation of its software to align and configure its data for compliance with ARAM. Please explain.**

Yes. Use of the Company's estimated composite remaining life of 41.49 years as the amortization period to return excess ADIT likely would not be consistent with ARAM, as explained in response to no. 2, above. As stated in the response to no. 1, above, Indiana-American continues to believe that adoption of estimated excess ADIT balances or estimated amortization periods that are not consistent with the balances and amortization periods produced by application of ARAM would expose the Company and its customers to substantial risk of incurring the severe penalties for violations of federal normalization requirements.

As noted in response to no. 1, above, Indiana-American believes it could make and utilize an estimate of the normalization of all estimated plant related excess ADIT balances that have been provided and do so pursuant to ARAM before year-end using a model that is closely enough aligned with ARAM as to be an estimate that, subject to true-up, could satisfy the normalization requirements. Again, while this course might pass IRS muster, it still would entail a greater risk of a normalization violation than allowing the Company the time to complete its 2018 ARAM calculation. Indiana-American continues to believe that completion of its ARAM calculation

before returning excess ADIT is the more prudent course, and the one that best protects the interests of its customers, particularly since the timing difference is only four or five months.

Respectfully submitted,

A handwritten signature in cursive script, reading "Hillary J. Close", is positioned above a horizontal line.

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## CERTIFICATE OF SERVICE

The undersigned attorney hereby certifies that a copy of the foregoing has been served upon the following via electronic mail this 30th day of November, 2018 to:

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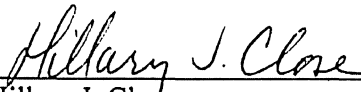
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