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INDIANA UTILITY
REGULATORY COMMISSION

VERIFIED DIRECT TESTIMONY

OF

NICHOLAS M. MILLER

ON BEHALF OF

INDIANAPOLIS POWER & LIGHT COMPANY

D/B/A AES INDIANA

Cause No. 45911

VERIFIED DIRECT TESTIMONY OF NICHOLAS M. MILLER

ON BEHALF OF AES INDIANA

1. INTRODUCTION

Q1. Please state your name, employer, and business address.

A1. My name is Nicholas M. Miller. I am employed by AES US Services, LLC, ("AES Services", also "Service Company"), which is the service company that serves Indianapolis Power & Light Company d/b/a AES Indiana ("AES Indiana", "IPL", or "the Company"). The Service Company is located at One Monument Circle, Indianapolis, Indiana 46204.

Q2. What is your position with AES Services?

A2. I am Senior Manager, Regulatory Tax for AES US Utilities & Conventional Generation.

Q3. On whose behalf are you submitting this direct testimony?

A3. I am submitting this testimony on behalf of AES Indiana.

Q4. Please describe your duties as Senior Manager, Regulatory Tax.

A4. As the Senior Manager of Regulatory Tax, I manage all aspects of federal and state income tax, property tax, sales and use tax, and other non-income tax accruals for the regulated utilities and conventional generation businesses that are part of AES US, including AES Indiana. In addition, I am also responsible for the forecasting of income and non-income taxes, preparation and filing of certain non-income tax returns, and the review of income tax returns prepared by AES. I work closely with the accounting, finance, legal, operations, and development teams. I also partner with the Arlington, Virginia AES tax group on a variety of US federal, state, and local tax matters.

Q5. Please summarize your education and professional qualifications.

A5. I have a bachelor's degree in business with majors in Accounting and Finance from Indiana University Kelley School of Business (Indianapolis) and hold an active Certified Public Accountant license from the state of Indiana.

Q6. Please summarize your prior work experience.

A6. I began my career with CliftonLarsonAllen LLP in 2014 as an Associate in the tax department in Indianapolis, Indiana. I was responsible for federal and state income tax compliance and income tax accounting for public and private corporations primarily in the manufacturing and energy industries. In 2017, I joined Heartland Food Products Group as Tax Manager responsible for all aspects of the company's federal and state income tax, property tax, and sales and use tax return filings. In 2018, I joined the Service Company as Tax Reporting Manager, primarily responsible for AES' consolidated US tax accruals as well as property tax management for the entire US Utilities & Conventional Generation business group. In 2021, I transitioned to my current role as Senior Manager, Regulatory Tax.

Q7. Have you testified previously before the Indiana Utility Regulatory Commission ("Commission") or any other regulatory agency?

A7. No.

Q8. What is the purpose of your testimony in this proceeding?

A8. The purpose of this testimony in this proceeding is to present and support federal, state, and local income taxes to which AES Indiana is subject as well as deferred federal and state income tax, investment tax credit ("ITC") adjustments, interest synchronization, imputation of parent company interest, and the effective income tax rate. I am also responsible for the calculation of the gross revenue conversion factor and adjustments to certain taxes other than income taxes, including real estate and personal property taxes. In addition, I present and support the updates to excess accumulated deferred income taxes ("ADIT"). The specific calculations and adjustments I support are listed in the questions below.

Q9. Are you sponsoring or co-sponsoring any financial exhibits or attachments?

A9. Yes. I sponsor or co-sponsor the following financial exhibits or attachments:

- AES Indiana Financial Exhibit AESI-REVREQ, Schedule REVREQ2 – Gross Revenue Conversion Factor
- AES Indiana Financial Exhibit AESI-OPER, Schedule OTX1 – Summary of Taxes Other Than Income Taxes
- AES Indiana Financial Exhibit AESI-OPER, Schedule OTX2 – Real Estate and Personal Property Taxes, Including Rail Car Tax
- AES Indiana Financial Exhibit AESI-OPER, Schedule OTX4 – Indiana Utility Receipts Tax ("URT")
- AES Indiana Financial Exhibit AESI-OPER, Schedule TX1 - Summary of Income Tax Expense
- AES Indiana Financial Exhibit AESI-OPER, Schedule TX2 – Current Federal Income Tax Expense

- AES Indiana Financial Exhibit AESI-OPER, Schedule TX3 – Current State Income Tax Expense
- AES Indiana Financial Exhibit AESI-OPER, Schedule TX4 – Deferred Federal and State Income Tax Expense
- AES Indiana Financial Exhibit AESI-OPER, Schedule TX5 – ITC Adjustments
- AES Indiana Financial Exhibit AESI-OPER, Schedule TX6 – Interest Synchronization
- AES Indiana Financial Exhibit AESI-OPER, Schedule TX7 – Imputation of Parent Company Interest
- AES Indiana Financial Exhibit AESI-OPER, Schedule TX8 – Effective Income Tax Rate

Q10. Did you submit any workpapers?

A10. Yes. The calculations shown on the schedules identified above have been cross-referenced, when appropriate, to the workpapers which provide additional detailed support for these calculations.

Q11. Were these exhibits, attachments, or workpapers, or portions thereof, that you are sponsoring or co-sponsoring prepared or assembled by you or under your direction and supervision?

A11. Yes.

Q12. Please explain the normalization method of accounting used for income taxes and ratemaking.

A12. For income tax return purposes, the Company's depreciation deductions are calculated using accelerated rates and lives provided for in the Internal Revenue Code. For regulatory and book accounting purposes, depreciation expense is calculated on a straight-line basis over the useful life of the relevant property using depreciation rates approved by the Commission. In order for the Company to continue its ability to claim accelerated depreciation on its tax returns, tax expense included in the cost of service must use the same depreciation method (the same life and method) as is used elsewhere for cost of service. The difference between the book and tax depreciation amounts result in a deferred tax – initially a deferred tax liability that begins to reverse once book depreciation exceeds tax depreciation until it ultimately fully reverses, and the deferred tax balance is zero. This deferred tax liability is allowed to be included as zero-cost capital by regulators. The regulatory treatment of depreciation and the related deferred taxes included in the income tax component of cost of service is referred to as the normalization method of accounting.

2. DESCRIPTION OF SCHEDULES

Q13. Please explain AES Indiana Financial Exhibit AESI-REVREQ, Schedule REVREQ2 – Gross Revenue Conversion Factor.

A13. This schedule shows the calculation of the factor necessary to determine the incremental amount of gross revenue required to generate an additional dollar of operating income after payment of all public utility assessment fees and federal and state income taxes. This exhibit calculates income tax expense based on the underlying financial data of the Company, including all applicable revenues and expenses. The income tax calculation includes both the current and deferred components of income tax expense, based upon current statutory rates. It should be noted that the gross revenue conversion factor excludes URT (Ind. Code Article 6-2.3), which was repealed effective July 1, 2022.[1]

Q14. Please explain AES Indiana Financial Exhibit AESI-OPER, Schedule OTX1 – Summary of Taxes Other Than Income Taxes.

A14. This schedule summarizes the total amount of taxes other than income taxes incurred by the Company for the test year with adjustments. It is divided into real estate and personal property taxes, payroll taxes, URT, and other miscellaneous taxes. The detail supporting the calculations on this schedule is shown on AES Indiana Financial Exhibit AESI-OPER, Schedules OTX2 through OTX4.[2]

Q15. Please explain AES Indiana Financial Exhibit AESI-OPER, Schedule OTX2 – Real Estate and Personal Property Taxes, Including Rail Car Tax.

A15. This schedule summarizes the property tax liabilities of the Company based on the most recent assessments and rates. The detail concerning the most recent assessed values and the most recent tax rates is set forth in Workpaper OTX2-WP1 and Workpaper OTX2-WP2 supporting AES Indiana Financial Exhibit AESI-OPER, Schedule OTX2. Adjustments are made to assessed value to reflect property additions and retirements during the test year that are not reflected on the 2022 assessments, as well as changes in the Company's abnormal obsolescence deduction.

Abnormal obsolescence is a deduction authorized in 50 IAC 5.1-11 to capture "…obsolescence which occurs as a result of factors over which the taxpayer has no control

[1] See Ind. P. L. 138-2022, Sec. 3.
[2] AES Indiana Financial Exhibit AESI-OPER, Schedule OTX3 is sponsored by AES Indiana witness Whitehead.

and is unanticipated, unexpected, and cannot reasonably be foreseen by a prudent businessperson prior to the occurrence. Abnormal obsolescence is of a nonrecurring nature and includes: (A) unforeseen changes in market values; (B) adverse governmental action; (C) exceptional technological obsolescence; or (D) destruction by catastrophe." These deductions are specific to the tax year and the revenue requirement would be overstated if this adjustment was not made. This is the same approach that was taken in Cause No. 45029.

After these adjustments, pro forma assessed value for the test year as shown on line 1 of AES Indiana Financial Exhibit AESI-OPER, Schedule OTX2 reflects the distributable personal property assessed value shown on the Company's 2023 Tentative Assessment dated 5/31/2023 based on property placed in service as of 12/31/2022.

As shown on AES Indiana Financial Exhibit AESI-OPER, Schedule OTX2 (line 8), property tax expense for the test year includes an adjustment to remove the property taxes associated with Petersburg Unit 2 which was retired May 31, 2023. This was calculated by multiplying the portion of total Petersburg assessed value related to Unit 2 on the most recent assessment by the currently enacted tax rate in the taxing district. The detail for this calculation is shown in Workpaper OTX2-WP4 supporting AES Indiana Financial Exhibit AESI-OPER, Schedule OTX2. The adjustment is necessary to annualize and normalize the decrease to property tax expense that is caused by retiring the unit during the adjustment period. In addition, test year property tax expense has also been adjusted to remove the deferral and amortization of Transmission, Distribution, and Storage System Improvement Charge ("TDSIC") property tax expense so that pro forma property tax expense includes all TDSIC assets placed in service as of the end of the test year. This is included within the adjustment shown on line 9 of this schedule. Any property tax expense on TDSIC assets placed in service after the test year will continue to be collected through the TDSIC Rider.

Q16. Please explain AES Indiana Financial Exhibit AESI-OPER, Schedule OTX4 – URT.

A16. This schedule calculates the Company's URT expense. As noted in Q/A 13, the URT was repealed effective July 1, 2022. As shown in AES Indiana Financial Exhibit AESI-OPER, Schedule OTX4 (line 14), an adjustment was made to remove the total test year URT expense of $11.1 million. A corresponding reduction to revenue is included in the adjustment in AES Indiana Financial Exhibit AESI-OPER, Schedule REV4 (column 5).[3]

Q17. Please explain AES Indiana Financial Exhibit AESI-OPER, Schedule TX1 – Summary of Income Tax Expense.

A17. This schedule summarizes the components of income tax expense during the test year, broken out by current and deferred tax expense as well as federal and state tax expense. The schedule summarizes income tax expense at both present and proposed rates, and includes various adjustments described in my testimony. The supporting detail for this schedule is outlined in AES Indiana Financial Exhibit AESI-OPER, Schedules TX2 through TX7.

Q18. Please explain AES Indiana Financial Exhibit AESI-OPER, Schedules TX2 (Current Federal Income Tax Expense) and TX3 (Current State Income Tax Expense).

A18. These schedules show the calculation of current federal and state income tax expense at present and proposed rates, both of which carry over into lines 1 and 2 on AES Indiana Financial Exhibit AESI-OPER, Schedule TX1. The calculation of federal income tax

[3] AES Indiana witness Baker, Direct Testimony, Q/A 17.

expense (current and deferred) begins with the determination of net operating income before tax (pre-tax operating income). Before we can apply the federal income tax rate of 21%, we must first adjust for permanent differences. These are items where, for instance, expenses may not be fully deductible for purposes of computing taxable income or where deductions may be allowed for tax purposes which are not reflected in the calculation of pre-tax operating income. Examples of permanent differences include certain meals and entertainment expenses and parking expenses, among others. These permanent differences are shown on lines 6 through 9 of AES Indiana Financial Exhibit AESI-OPER, Schedule TX2. To compute the current portion of federal income tax expense (as compared to the deferred portion), we must also account for temporary differences. Temporary differences are items where the timing of expense deduction or income inclusion differs for federal taxable income as compared to pre-tax operating income. The most common of these differences is the use of accelerated methods of depreciation for tax. The temporary differences are shown on lines 10 through 53 of AES Indiana Financial Exhibit AESI-OPER, Schedule TX2.

Next, a deduction for synchronized interest is shown on line 54 of AES Indiana Financial Exhibit AESI-OPER, Schedule TX2. AES Indiana Financial Exhibit AESI-OPER, Schedule TX6 shows the calculation of the amount of interest expense deduction used by the Company for purposes of computing income tax expense. This amount is calculated by multiplying the adjusted rate base by the weighted cost of long-term debt. This interest expense deduction methodology is consistent with past Commission practice. The next adjustment is for the allocation of parent company interest, which is shown on line 55 of AES Indiana Financial Exhibit AESI-OPER, Schedule TX2. Consistent with the methodology used and accepted in the Company's last two base rate cases (Cause No. 44576 and Cause No. 45029), this is an adjustment to reduce the Company's income tax expense for an allocated share of the tax benefit associated with the interest expense incurred by its parent company (The AES Corporation) as a result of the Company's participation in The AES Corporation's consolidated income tax return filings. This calculation is illustrated in <u>AES Indiana Financial Exhibit AESI-OPER, Schedule TX7</u>. The computation reflected in <u>AES Indiana Financial Exhibit AESI-OPER, Schedule TX7</u> includes an adjustment to remove the portion of the Company's capital contributed by CDPQ, as the Company neither engages in, nor benefits from, the filing of a consolidated income tax return with this entity.[4]

State income tax expense is then deducted to arrive at federal taxable income for purposes of computing current federal income tax expense at present and proposed rates. <u>AES Indiana Financial Exhibit AESI-OPER, Schedule TX3</u> provides a calculation of current state income tax expense. The starting point for state income tax expense is federal taxable income, which is then adjusted to account for additional state permanent and temporary differences to arrive at state taxable income. State taxable income is then multiplied by 4.9%, which is the currently enacted Indiana statutory tax rate. Consistent with the approach from Cause No. 45029, both federal and state current tax expense include an adjustment to remove expense recorded during the test year related to the return-to-accrual entries resulting from the filing of the prior year federal and state income tax return. These

[4] CDP Infrastructure Fund GP, a wholly-owned subsidiary of La Caisse de depot et placement du Quebec ("CDPQ"), owns a minority equity interest in IPALCO, AES Indiana's immediate parent company.

adjustments are reflected on line 63 of AES Indiana Financial Exhibit AESI-OPER, Schedule TX2 and line 12 of AES Indiana Financial Exhibit AESI-OPER, Schedule TX3.

Q19. Did the Company include an adjustment to remove the impacts of the non-deductibility of the URT in the computation of state income tax expense?

A19. Yes. As stated above, the URT was repealed effective July 1, 2022. URT was nondeductible for Indiana state taxable income and therefore creates additional Indiana state income tax expense. As such, an adjustment was made on line 2 of AES Indiana Financial Exhibit AESI-OPER, Schedule TX3 to remove the $11.1 million URT addback to state taxable income to reflect the repeal of URT going forward.

Q20. Please explain AES Indiana Financial Exhibit AESI-OPER, Schedule TX4 – Deferred Federal and State Income Tax.

A20. This schedule shows the itemization of the components of federal and state deferred income tax expense at present and proposed rates. The totals on lines 3 and 4 of AES Indiana Financial Exhibit AESI-OPER, Schedule TX1 are drawn from lines 47-53 from AES Indiana Financial Exhibit AESI-OPER, Schedule TX4. Each component feeding the calculation of deferred income tax is listed in this schedule. Consistent with the approach from Cause No. 45029, both federal and state deferred tax expense include an adjustment to remove expense recorded during the test year related to the return-to-accrual entries resulting from the filing of the prior year federal and state income tax return. These adjustments are reflected on line 49 of AES Indiana Financial Exhibit AESI-OPER, Schedule TX4.

Q21. Please explain AES Indiana Financial Exhibit AESI-OPER, Schedule TX5 – ITC Adjustments.

A21. This schedule reflects the test year amortization of ITCs previously reflected on Federal tax returns over the service life of the property that generated the credits, which carries over into line 5 on AES Indiana Financial Exhibit AESI-OPER, Schedule TX1.

Q22. Please explain AES Indiana Financial Exhibit AESI-OPER, Schedule TX6 – Interest Synchronization.

A22. As discussed above in Q/A 18, this schedule shows the calculation of the amount of interest expense deduction used by the Company for purposes of computing income tax expense, which is then carried to line 54 on AES Indiana Financial Exhibit AESI-OPER, Schedule TX2. This amount is calculated by multiplying the adjusted original cost rate base reflected on AES Indiana Financial Exhibit AESI-RB, Schedule RB-1 by the weighted cost of long-term debt. This interest expense deduction methodology was used and accepted in the Company's last two base rate cases (Cause No. 44576 and Cause No. 45029).[5]

Q23. Please explain AES Indiana Financial Exhibit AESI-OPER, Schedule TX8 – Effective Tax Rate.

A23. This schedule calculates the Company's effective tax rate after taking into consideration permanent and flow-through timing differences, investment tax credit amortization, and amortization of excess ADIT. The total effective tax rate is 17.52% and is calculated by dividing total income tax expense by pre-tax electric operating income including interest expense. The effective tax rate is different from the combined federal and state statutory

[5] AES Indiana Financial Exhibit AESI-RB, Schedule RB-1 is sponsored by AES Indiana witness Coklow.

rate of 24.871% primarily due to the impact of excess ADIT amortization and parent company interest.

3. <u>Excess ADIT Amortization</u>

Q24. Please describe the normalization method of accounting as it relates to excess ADIT under the Tax Cuts and Jobs Act ("TCJA").

A24. Section 13001(d) of the TCJA provides that:

> [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.

Therefore, the amortization of excess ADIT related to "normalized" property (i.e., book/tax differences related to life and method) must be calculated under the Average Rate Assumption Method ("ARAM") in order to comply with the normalization provisions of the Internal Revenue Code. The amortization period of other "non-normalized" excess ADIT is not governed under the Internal Revenue Code.

Q25. How was amortized excess ADIT treated in Cause No. 45029?

A25. The settlement agreement approved in the Company's last rate case (Cause No. 45029) provided as follows for Normalized and Non-Normalized Excess ADIT:

> <u>Pro Forma Normalized Excess ADIT</u>. Normalized excess ADIT created by the TCJA will be amortized over the remaining life of the assets as required by statute using the average rate assumption method ("ARAM"). Until the ARAM calculation is determined, the amortization will be straight-line over 25 years as described in the testimony of IPL Witness Salatto.

and

> Pro Forma Non-Normalized Excess ADIT. Non-normalized excess ADIT created by the TCJA will be amortized over approximately 7 years, which is a decrease from the ten-year amortization period proposed in IPL's update to its case-in-chief for the TCJA filed on February 16, 2018.[6]

The settlement testimony of Company witness Cutshaw explained (QA 30) that:

> The TCJA impacts are preliminary estimates and subject to change. Final values will not be available until after IPL's 2017 tax return is filed. Amounts in the normalized and non-normalized categories may be revised to align with final accounting values and to avoid any normalization violations. The Settling Parties agreed to the extent that the actual annual amortization of the normalized Excess ADIT differs from the estimated amount reflected in the Settlement Agreement, the amortization of the non-normalized excess ADIT will be increased or decreased to ensure that the total annual amortization of normalized and non-normalized excess ADIT is equal to $9.262 million as reflected on IPL Financial Exhibit IPL-CC, Schedule CC3-S.

Thus, the settlement agreement in Cause No. 45029 recognized that in order to ensure that the amortization remains in compliance with tax normalization rules, the amount of any non-normalized amortization would be increased or decreased so that the total amortization remains $9.262 million per year and that normalized amortization agrees to the ARAM calculation.

Q26. Have the excess ADIT balances been updated since AES Indiana's last rate case in Cause No. 45029?

A26. Yes. The excess ADIT balances for both normalized and non-normalized property have been updated. As indicated above, at the time of the Company's last rate case, Cause No. 45029, the 2017 income tax return had not yet been filed and therefore an estimate of the excess ADIT was computed. The estimated amount of normalized excess ADIT was $99.0 million while the estimated amount of non-normalized excess ADIT was $37.1 million. The excess ADIT balances have been updated to reflect the final amounts following the

[6] See Settlement Agreement approved in Cause No. 45029 at Section 5.2.

filing of the 2017 federal income tax return. The result was a total increase in excess ADIT of $3.8 million (excluding the gross-up for income taxes), of which ($8.5) million relates to normalized property and $12.3 million relates to non-normalized property. This is shown on Workpaper TX4-WP4, line 2 supporting AES Indiana Financial Exhibit AESI-OPER, Schedule TX4. In addition, the estimated excess ADIT balances used in Cause No. 45029 were reallocated between normalized and non-normalized property. The result was a net increase to the normalized property of $57.6 million and a net decrease to the non-normalized property by the same amount, as shown on Workpaper TX4-WP4, lines 3 and 4 supporting AES Indiana Financial Exhibit AESI-OPER, Schedule TX4. After accounting for these modifications, the final excess ADIT balance that was recorded following the TCJA was $139.9 million, of which $148.0 million relates to normalized property and ($8.2) million relates to non-normalized property, as shown on Workpaper TX4-WP4, line 5 supporting AES Indiana Financial Exhibit AESI-OPER, Schedule TX4.

At the conclusion of the December 31, 2022 test year in the current case, the Company has cumulatively amortized $46.3 million of excess ADIT. Of that total, $22.4 million relates to normalized property as determined by the ARAM calculation, and $23.9 million relates to non-normalized property. These amounts are summarized by year on Workpaper TX4-WP4, lines 7-12 supporting AES Indiana Financial Exhibit AESI-OPER, Schedule TX4. After accounting for the changes in the beginning excess ADIT balances described above and the cumulative amortization, the balances of excess ADIT as of the end of the test year in the current case is $93.6 million, of which $125.6 million relates to normalized property and ($32.1) million relates to non-normalized property. This is summarized on Workpaper TX4-WP4, line 13 supporting AES Indiana Financial Exhibit AESI-OPER, Schedule TX4.

Q27. Please explain the reallocations of normalized excess ADIT described in Q/A 26.

A27. As explained above in Q/A 25, the settlement agreement in the Company's last rate case stated that the normalized and non-normalized balances were preliminary estimates that may be revised. In accordance with this, the Company made two reallocations between the normalized and non-normalized excess ADIT balances totaling $57.6 million. The first was to reallocate basis differences on fixed assets that were included in the original estimate of the normalized balance in Cause No. 45029. These basis differences are non-normalized property, and this reallocation is necessary to align the normalized balance with the final calculations within the Company's tax depreciation software, PowerTax. The result is a decrease of the normalized balance by $38.9 million and an increase to the non-normalized balance by the same amount. This is shown on Workpaper TX4-WP4, line 3 supporting AES Indiana Financial Exhibit AESI-OPER, Schedule TX4.

The second reallocation was related to cost of removal. The tax rules do not permit a tax deduction for cost of removal until the period in which the cash is paid, resulting in a deferred tax asset for the cost of removal included in book depreciation expense. At the time of the Company's last rate case, cost of removal was included within the normalized excess ADIT balance which reduced the total normalized balance. However, in 2020 the Internal Revenue Service issued Private Letter Ruling ("PLR") 202033002 which ruled that cost of removal related net deferred tax assets are not protected by the normalization rules. In accordance with this PLR, the Company has reallocated the cost of removal excess ADIT to non-normalized property, which results in an increase in the normalized balance of $96.5 million and a decrease to the non-normalized balance by the same amount. This is shown on Workpaper TX-4 WP4, line 4 supporting AES Indiana Financial Exhibit AESI-OPER, Schedule TX4.

These two reallocations result in a total increase in the normalized excess ADIT balance of $57.6 million and a decrease in the non-normalized excess ADIT balance by the same amount, which is necessary to ensure compliance with the tax normalization rules and avoid a normalization violation.

Q28. How is the Company treating excess ADIT in this case?

A28. The Company has included an estimate of excess ADIT amortization in base rates totaling $3.4 million per year, which is a decrease of $5.9 million compared to the amount established in Cause No. 45029. This is shown on AES Indiana Financial Exhibit AESI-OPER, Schedule TX4, line 45, and includes only normalized amortization as shown on Workpaper TX4-WP4, line 20 supporting AES Indiana Financial Exhibit AESI-OPER, Schedule TX4.

Q29. How did the Company calculate the annual estimate of normalized excess ADIT amortization?

A29. In order to comply with the normalization rules discussed in Q/A 24, the Company will amortize normalized excess ADIT using ARAM. Using the 2022 ARAM calculation as an estimate, it results in $3.4 million of annual normalized excess ADIT amortization.

Q30. How did the Company calculate the annual estimate of non-normalized excess ADIT amortization?

A30. The balance of non-normalized excess ADIT as of December 31, 2022, before considering cost of removal, is $64.4 million, as shown on Workpaper TX4-WP4, line 13 supporting

AES Indiana Financial Exhibit AESI-OPER, Schedule TX4. In order to determine the amount of non-normalized excess ADIT that must be amortized in this case, the balance must be projected to June 30, 2024, which is expected to be just prior to when rates in this cause will be effective. This estimate is summarized on Workpaper TX4-WP4, lines 14-16 supporting AES Indiana Financial Exhibit AESI-OPER, Schedule TX4 and results in non-normalized amortization of $5.9 million for calendar year 2023 and $3.0 million for January 1, 2024 through June 30, 2024. These amounts were calculated by taking total annual amortization of $9.3 million and subtracting $3.4 million in annual normalized amortization leaving $5.9 million as the annual non-normalized amortization. After factoring in this projection, the balance of non-normalized excess ADIT excluding cost of removal at June 30, 2024, immediately prior to when rates in this cause are expected to be effective, is $55.5 million. Next, this balance must be netted with the cost of removal reallocation described in Q/A 27. This is shown on Workpaper TX4-WP4, lines 17-18 supporting AES Indiana Financial Exhibit AESI-OPER, Schedule TX4. After considering this reallocation, the non-normalized excess ADIT balance has been fully amortized, leaving a net deficient ADIT balance related to cost of removal of $40.9 million at June 30, 2024. Since the non-normalized excess ADIT has been fully amortized, the Company has not reflected any non-normalized excess ADIT amortization in this case.

Q31. How does the Company now propose to account for the difference between the estimate of excess ADIT amortization and the actual amount so as to avoid a normalization violation?

A31. To the extent that the actual annual amortization differs from the estimated amount, the balance of the non-normalized deficient ADIT described in Q/A 30 will be increased or decreased to ensure that the total amortization of normalized and non-normalized excess ADIT is equal to $3.4 million, and the normalized amortization is equal to ARAM. For example, if the final ARAM calculation results in $4.0 million of annual normalized excess ADIT amortization, then the non-normalized deficient ADIT balance will decrease by $0.6 million (the difference between ARAM of $4.0 million and the estimate of $3.4 million). This approach may result in a residual balance of non-normalized excess or deficient ADIT that will remain once the normalized balance is fully amortized, which is dependent on the result of the annual ARAM calculation and cannot be estimated at this time. The treatment of the residual non-normalized balance will be addressed in a future proceeding. This accounting treatment is necessary to ensure the Company remains in compliance with tax normalization rules, therefore avoiding a tax normalization violation, and represents the fastest possible return of the excess ADIT for the benefit of customers.

Q32. Please explain how a normalization violation would impact the Company's customers.

A32. As explained in Q/A 12, the Company must use a normalization method of accounting in order to continue to claim accelerated depreciation on its federal income tax returns. Accelerated depreciation is the source of a significant portion of the Company's deferred tax liabilities, and this is expected to continue for the foreseeable future. Since the deferred tax liabilities are included as zero-cost capital by regulators, if the Company lost its ability to claim accelerated depreciation, then deferred tax liabilities would decrease and the rate of return would increase. The regulatory accounting treatment described in Q/A 31 ensures that a normalization violation does not occur with respect to excess ADIT and that customers continue to get the benefits of accelerated depreciation through deferred taxes included in the cost of capital.

4. <u>SUMMARY AND RECOMMENDATIONS</u>

Q33. Please summarize your testimony and recommendations.

A33. The Company has accurately reflected income taxes and taxes other than income taxes in the revenue requirement in this case. The calculations made to derive these expenses are reasonable and consistent with the methodology used in prior Commission proceedings, and the test year adjustments are fixed, known, and measurable. In addition, the excess ADIT balances have been updated to reflect the final accounting records and cumulative amortization following the passage of the TCJA, and the pro forma adjustment to excess ADIT amortization is reasonable and in compliance with the tax normalization rules. In order to avoid a normalization violation, the tax expense included in the cost of service must use the same depreciation method and life used elsewhere for cost of service, and the amortization of normalized excess ADIT must be calculated using ARAM. The proposed treatment of excess ADIT in this case is necessary to avoid a potential normalization violation. It is imperative that a normalization violation be avoided, which will allow the Company to continue to claim accelerated depreciation on its tax returns. This creates a deferred tax liability which is included as zero-cost capital to the benefit of customers.

Q34. Does this conclude your verified pre-filed direct testimony?

A34. Yes

VERIFICATION

I, Nicholas M. Miller, Senior Manager, Regulatory Tax for AES US Services, LLC affirm under penalties for perjury that the foregoing representations are true to the best of my knowledge, information, and belief.

Nicholas M. Miller

Nicholas M. Miller
Dated: June 28, 2023