

**FILED**  
May 14, 2019  
**INDIANA UTILITY  
REGULATORY COMMISSION**

I&M Exhibit: \_\_\_\_\_

Cause No. 45235

**INDIANA MICHIGAN POWER COMPANY**

**PRE-FILED VERIFIED DIRECT TESTIMONY**

**OF**

**MICHAEL N. KELLY**

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**PRE-FILED VERIFIED DIRECT TESTIMONY OF MICHAEL N. KELLY  
ON BEHALF OF  
INDIANA MICHIGAN POWER COMPANY**

1 **Q. Please state your name, position, and business address.**

2 A. My name is Michael N. Kelly. I am the Manager - Taxes of Tax Accounting and  
3 Regulatory Support for American Electric Power Service Corporation (AEPSC).  
4 AEPSC supplies engineering, financing, accounting, planning, advisory, and other  
5 services to the subsidiaries of the American Electric Power (AEP) system, one of  
6 which is Indiana Michigan Power Company (I&M or the Company). My business  
7 address is 1 Riverside Plaza, Columbus, Ohio 43215.

8 **Q. Please briefly describe your educational background and professional  
9 experience.**

10 A. I earned a Bachelor of Science Degree in Accounting from Virginia Polytechnic  
11 Institute and State University (Virginia Tech) in 1984. I have been a Certified Public  
12 Accountant since 1987. I joined Appalachian Power Company, a subsidiary of AEP,  
13 in April 1984 as an Associate Staff Accountant. I was promoted to Staff Accountant  
14 in 1986, Accounting Staff Assistant II in 1989, Accounting Staff Assistant in 1992,  
15 General Records Supervising Accountant in January 1996, and General Records  
16 Supervisor in December 1996. I was promoted to Administrator of Regulated  
17 Accounting in May 1998 and transferred to the AEPSC. In 2000, I transferred to the  
18 Corporate Development as the Principal Financial Coordinator; in 2001, I transferred  
19 to the Tax Department as Tax Project Manager. I was promoted to my current  
20 position effective January 1, 2005.

1 **Q. What are your responsibilities as Manager of Taxes – Tax Accounting and**  
2 **Regulatory Support?**

3 A. As Manager of Taxes – Tax Accounting and Regulatory Support, my responsibilities  
4 include participation in the recording of the tax accounting entries and records of AEP  
5 and its subsidiaries. I am also responsible for coordinating and developing State and  
6 Federal tax data provided by the AEPSC Tax Department for regulatory proceedings.  
7 Included in my responsibilities are participation in the recording of accounting entries  
8 and records related to Statement of Financial Accounting Standards No. 109 (SFAS  
9 109), “Accounting for Income Taxes,” and the associated regulatory assets and  
10 liabilities. I have attended numerous tax, accounting, and regulatory seminars  
11 throughout my professional career.

12 **Q. Have you previously testified in any regulatory proceeding?**

13 A. Yes. I have filed testimony and testified before the Virginia State Corporation  
14 Commission on behalf of Appalachian Power Company. I have also filed testimony  
15 before the Michigan Public Service Commission and the Indiana Utility Regulatory  
16 Commission on behalf of Indiana Michigan Power Company. In addition, I have filed  
17 testimony with the Public Service Commission of Kentucky on behalf of Kentucky  
18 Power Company, the Public Service Commission of West Virginia, the Public Utility  
19 Commission of Texas on behalf of AEP Texas and with the Federal Energy  
20 Regulatory Commission in a transmission rate case for the eastern AEP Operating  
21 Companies.

**PURPOSE OF TESTIMONY**

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

A. The purpose of my testimony in this proceeding is to present and support the following:

- Federal and state income tax expense for the historical period ended December 31, 2018 and for the forward-looking test period ended December 31, 2020 (Test Year).
- Income tax expense adjustments related to certain ratemaking adjustments made to the Test Year as supported by other Company witnesses.
- Calculation of the gross revenue conversion factor and certain taxes other than income taxes.
- Calculation of effective federal income tax rates.

**Q. Are you sponsoring any exhibits in this proceeding?**

A. I am sponsoring the following exhibits or portions of exhibits:

- Exhibit A-5: List of Tax Expense Adjustments.
- Exhibit A-8: Test Year Calculation of Gross Revenue Conversion Factor.
- Exhibit A-9: Test Year Effective Tax Rate.

**Q. Are you sponsoring any attachments in this proceeding?**

A. I am sponsoring the following attachments to my direct testimony:

- Attachment MNK-1: Test Year State Income Tax Rate
- Attachment MNK-2: Test Year Interest Synchronization

**Q. Are you sponsoring any workpapers in this proceeding?**

A. I am sponsoring the following workpapers:

- 1           • WP-MNK-1: Test Year Tax Expense Computations

2 I also sponsor the following sections of I&M-WP-1 (Total Company):

- 3           • I&M-WP-1-7: Historic Tax Expense  
4           • I&M-WP-1-8: Historic Parent Co. Net Interest Tax Benefit  
5           • I&M-WP-1-9: Historic Gross Revenue Conversion Factor  
6           • I&M-WP-1-10: Historic Effective Federal Income Tax Rate  
7           • I&M-WP-1-11: Historic Effective State Income Tax Rate

8 **Q. Were the exhibits, attachments, and workpapers that you are sponsoring**  
9 **prepared by you or under your direction?**

10 A. Yes.

11 **FEDERAL AND STATE INCOME TAX EXPENSE**

12 **Q. Please describe the methodology used to develop the federal and state income**  
13 **tax expense for the Test Year.**

14 A. Consistent with prior rate filings and Commission Orders including Cause Nos.  
15 44967, 44075, and 43306, the Company's federal and state income tax expense are  
16 calculated using the *stand-alone* or *separate* return methodology. The Company's  
17 income tax expense is based in large part on the components of Company pre-tax  
18 book income and expense presented by Company witness Nancy Heimberger, and  
19 the forecast of other various Schedule M items that would impact the computation of  
20 current and deferred income tax expense for the Test Year. The computations also  
21 include reversals of deferred taxes and amortization of deferred investment tax  
22 credits utilized in prior years.

1           Workpaper WP-MNK-1 shows the calculation of Test Year federal income tax  
2           expense. All deferred federal income taxes were computed based on the related  
3           Schedule M items as presented in the Company's forecast. (The Company's  
4           forecast process is explained in detail by Company witness Heimberger.) In addition,  
5           the workpapers show the calculation of the Test Year state income tax expense. This  
6           was developed using the most recent available state tax rates and apportionment  
7           factors.

8           The Company's state and federal income tax expense has been properly  
9           recomputed to reflect the appropriate tax effects resulting from the various  
10          ratemaking adjustments supported in this case.

11 **Q. Please describe the methodology used to develop Taxes Other Than Income**  
12 **tax expense for the Test Year.**

13 A. The Test Year level of forecasted Taxes Other Than Income Tax expense is  
14          representative of these types of ongoing tax expenses except for those tax  
15          adjustments that I am sponsoring in this proceeding. The adjusted Test Year level  
16          of other tax expense is appropriate and necessary and reflects the proper amount of  
17          going-level expense.

18 **Q. Please describe the calculation of the effective state income tax rate as shown**  
19 **on Attachment MNK-1.**

20 A. Attachment MNK-1 shows the composite state income tax rate developed by using  
21          the appropriate state income tax rates and apportionment factors. This composite  
22          rate is used to compute current state income tax expense and is used in the  
23          development of the Gross Revenue Conversion Factor.

1 **Q. Please describe the calculation of interest synchronization for federal income**  
2 **tax as shown on Attachment MNK-2.**

3 A. Attachment MNK-2 shows the calculation of the amount of interest expense  
4 deduction used by the Company for purposes of computing income tax expense.  
5 This amount is calculated by multiplying the adjusted rate base by the weighted cost  
6 of long-term debt. This interest expense deduction methodology is consistent with  
7 past Commission practice including Cause Nos. 44967, 44075, and 43306.

8 **Q. Please describe the development of the federal and state income tax expense**  
9 **for the historic period.**

10 A. The Company's historical income tax expense is based on the actual amounts  
11 recorded on the books of I&M. The historical income tax expense has been adjusted  
12 for out-of-period or non-ongoing items and is presented in I&M-WP-1-7 for  
13 informational purposes only.

14 As with federal and state income tax in the Test Year, the Company's  
15 historical federal and state income tax expense is calculated using the *stand-alone*  
16 or *separate* return methodology.

17 **WEIGHTED AVERAGE COST OF CAPITAL**

18 **Q. Did you provide the balances of accumulated deferred federal income taxes**  
19 **(ADFIT) and accumulated deferred investment tax credits (ADITC) used by**  
20 **Company Witness Messner in his Exhibit A-7?**

21 A. Yes. We calculated and provided balances of \$1,251,804,495 and \$1,297,621,545  
22 for ADFIT and \$24,174,484 and \$18,960,268 for ADITC for the years 2019 and 2020,  
23 respectively used by Company witness Messner.



**TAX EXPENSE ADJUSTMENTS**

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**Q. What Tax Expense Adjustments are you sponsoring?**

A. I am sponsoring ratemaking Tax Expense Adjustment Nos. 1-3, as shown on Exhibit A-5. Each of these adjustments is necessary in order to reflect an adjusted Test Year level of tax expense that is representative of ongoing operations.

Exhibit A-5 presents Tax Expense Adjustments Nos. 1-3 on a total Company basis. Company witness Duncan is responsible for all jurisdictional amounts associated with these adjustments.

**Q. Please describe Tax Expense Adjustment No. 1.**

Tax Expense Adjustment No. 1 decreases the total Company state income tax expense by \$459,957 to reflect the adjustments to state taxable income resulting from the ratemaking adjustments supported by various Company witnesses that affect pre-tax state book income and the related Schedule M adjustments. This adjustment includes all state income tax expense where the Company has a business presence. Consistent with past rate treatment by this Commission, no deferred state income tax expense has been recorded in utility cost of service.

**Q. Please describe Tax Expense Adjustment No. 2.**

A. Tax Expense Adjustment No. 2 decreases the total Company Current Federal Income Tax (CFIT) expense by \$689,658 to reflect the current federal income tax effect at 21% of the federal taxable income related to the ratemaking adjustments supported by various Company witnesses, which affect pre-tax book income and the related federal income tax Schedule M adjustments. CFIT expense has been adjusted by I&M's allocated share of the tax benefit of the net interest expense portion

1 of the parent company (American Electric Power Co. Inc.) tax loss as a result of the  
2 Company's participation in the AEP consolidated federal income tax return. This  
3 methodology is consistent with the Commission's December 22, 1982 Order in  
4 Cause No. 36760; the Commission's November 12, 1993 Order in Cause No. 39314;  
5 and all subsequent Commission Orders. I&M-WP-1-8 shows the computation of this  
6 amount.

7 **Q. Please describe Tax Expense Adjustment No. 3.**

8 A. Tax Expense Adjustment No. 3 decreases the total Company Deferred Federal  
9 Income Tax (DFIT) expense by \$7,280,575 to reflect the appropriate adjustments to  
10 DFIT expense at 21% of the normalized Schedule M adjustments arising from the  
11 ratemaking adjustments.

12 Tax Expense Adjustment No. 3 also increases total Company Deferred  
13 Investment Tax Credit (DITC) amortization by \$809,517. This adjustment is  
14 necessary to reflect the proper level of amortization based on the new book  
15 depreciation rates that are being recommended in this filing by Company witness  
16 Cash. In addition, the DITC amortization is being adjusted to reflect the Solar  
17 Investment Projects in which the Investment Tax Credits previously earned are  
18 anticipated to be fully utilized in 2019 by I&M as a result of its participation in the AEP  
19 Consolidated Federal Income Tax Return. These DITCs are being amortized over  
20 the estimated remaining book life of the various Solar Projects.

1 **Q. Does the total deferred income tax expense contain deferred federal income**  
2 **tax expense credits for the amortization of excess normalized and non-**  
3 **normalized Accumulated Deferred Federal Income Taxes (ADFIT)?**

4 A. Yes. Deferred federal income tax expense reflects a credit to Indiana jurisdictional  
5 deferred federal income tax expense of \$5,243,056 for the amortization of normalized  
6 excess ADFIT using ARAM which reduces the excess tax reserve over the remaining  
7 regulatory lives of the property that gave rise to the reserve for deferred taxes during  
8 the years in which the deferred tax reserve related to such property is reversing.  
9 Deferred federal income tax expense also reflects a credit to Indiana jurisdictional  
10 deferred federal income tax expense of \$24,656,944 for the amortization of non-  
11 normalized excess ADFIT.

12 **Q. Does deferred federal income tax expense reflect the amortization and**  
13 **treatment afforded the Company in its last rate case, Cause No. 44967, for the**  
14 **excess normalized and non-normalized ADFIT?**

15 A. Yes. The Final Order in Cause No. 44967, which approved a settlement agreement,  
16 provided that the total annual amortization of normalized and non-normalized excess  
17 ADFIT was to equal \$29.9 million. To the extent that the actual annual amortization  
18 using ARAM differed from the estimated amount in the filing, the amortization of non-  
19 normalized excess ADFIT is increased or decreased to equal the \$29.9 million.  
20 Deferred federal income tax expense reflects a total of \$29.9 million credit to Indiana  
21 jurisdictional deferred federal income tax expense relative to the amortization of  
22 normalized excess ADFIT using ARAM and the amortization of non-normalized  
23 excess ADFIT.

1 **Q. Did you provide the estimated Indiana jurisdictional balance of excess non-**  
2 **normalized accumulated deferred federal income taxes (ADFIT) at December**  
3 **31, 2020 included as an adjustment to rate base and sponsored by Company**  
4 **Witness Williamson?**

5 A. Yes. We calculated and provided an estimated Indiana jurisdictional non-normalized  
6 excess ADFIT balance of \$46,007,835 used by Company Witness Williamson that is  
7 reflected as a rate base reduction.

8 **GROSS REVENUE CONVERSION FACTOR**

9 **Q. Please describe the calculation of the Gross Revenue Conversion Factor as**  
10 **shown on Exhibit A-8.**

11 A. The Gross Revenue Conversion Factor calculated on Exhibit A-8 indicates the  
12 appropriate factor that should be applied to the income deficiency in order to  
13 determine the amount of incremental revenue needed to obtain the required level of  
14 operating income. It is necessary to apply this factor to the income deficiency in order  
15 to provide sufficient revenues to cover the additional federal and state income tax  
16 expense, the Indiana Utility Receipts Tax expense the public utility assessment fees  
17 and uncollectible accounts expense.

18 **EFFECTIVE FEDERAL INCOME TAX RATE**

19 **Q. Please describe the calculation of the effective federal income tax rate as**  
20 **shown on Exhibit A-9.**

21 A. Exhibit A-9 calculates the Company's effective federal income tax rate after taking  
22 into consideration permanent and flow-through timing differences, excess deferred  
23 federal income taxes, and deferred investment tax credit amortization. The overall

1 effective federal income tax rate before rate relief is -35.42% and is calculated by  
2 dividing total federal income tax expense by pre-tax electric operating income  
3 including interest expense. The negative effective tax rate is primarily due to the  
4 deferred income tax expense credits resulting from the amortization of excess ADFIT  
5 of \$29.9 million.

6 **Q. Does this conclude your pre-filed verified direct testimony?**

7 A. Yes.

**VERIFICATION**

I, Michael N. Kelly, Manager of Taxes of Tax Accounting and Regulatory Support of American Electric Power Service Corporation (AEPSC), affirm under penalties of perjury that the foregoing representations are true and correct to the best of my knowledge, information, and belief.

Date: 5/7/19

  
Michael N. Kelly

**INDIANA MICHIGAN POWER COMPANY**Calculation of Effective State Income Tax Rate  
Forecast Year Ended December 31, 2020

Attachment MNK-1

Page 1 of 1

Witness: M. N. Kelly

Line No.	Column A	Column B	Column C
1	State Income Tax Rate - Indiana	5.375%	
2	Apportionment Factor	74.4700%	
3	Effective Indiana State Income Tax Rate		4.0028%
4	State Income Tax Rate - Illinois	9.500%	
5	Apportionment Factor	1.1849%	
6	Effective Illinois State Income Tax Rate		0.1126%
7	State Income Tax Rate - Kentucky	5.000%	
8	Apportionment Factor	1.3891%	
9	Effective Kentucky State Income Tax Rate		0.0695%
10	State Income Tax Rate - Michigan	6.000%	
11	Apportionment Factor	15.4633%	
12	Effective Michigan State Income Tax Rate		0.9278%
13	State Income Tax Rate - West Virginia	6.500%	
14	Apportionment Factor	2.2067%	
15	Effective West Virginia State Income Tax Rate		0.1434%
16	State Income Tax Rate - Missouri	4.000%	
17	Apportionment Factor	0.0030%	
18	Effective Missouri State Income Tax Rate		0.0001%
19	Total Effective State Income Tax Rate		<u>5.2562%</u>

**INDIANA MICHIGAN POWER COMPANY**

Calculation of Interest Synchronization for FIT  
Test Year Ended December 31, 2020

Attachment MNK-2  
Page 1 of 1  
Witness: M. N. Kelly

<u>Line No.</u>	<u>Column A</u>	<u>Total Company</u>	<u>Indiana Jurisdiction</u>
1	Adjusted Original Cost Rate Base	\$ 6,756,243,261	\$ 4,946,962,201
2	Weighted Cost Rate of Long-Term Debt	<u>1.94%</u>	<u>1.94%</u>
3	Synchronized Interest Deduction	<u>\$ 131,071,119</u>	<u>\$ 95,971,067</u>