

THE YORK WATER COMPANY

Response to Data Requests of the Pennsylvania Public Utility Commission Concerning Effects of the Tax Cuts and Job Act

M-2018-2641241

- Q. 1. How does the reduction in the corporate Federal Income Tax rate from 35% to 21% affect your federal tax obligations for calendar year 2018 and subsequent tax years? Please quantify your response as to the effect on both current and deferred tax obligations.
- A. 1. The effect from 2017 based on actual results is included on Attachment C. Projected proforma adjustments have been included based on projected 2018 results for net operating income and tax depreciation. The projected impact on both current and deferred tax obligations for 2018 are presented on Attachment C. Subsequent tax years have not been projected.
- Q. 2. If a reduced tax obligation is passed through to ratepayers, explain the methodology to be used to compute the reduction, the rate mechanism to accomplish the reduction, and the allocation among customer classes.
- A. 2. York Water recovers federal income tax expenses in base rates. The preferred and most accurate method for adjusting base rates to reflect changes in federal tax rates is to do so in a general rate proceeding. In a general rate proceeding all elements of utility costs, including return and depreciation on utility plant, can be evaluated. Changes in a utility's revenues and expenses since its last rate case will change, and likely reduce, both operating and taxable income. Importantly, and not recognized in Attachment C to the Commission's Secretarial Letter, increases in net utility plant will reduce a utility's return. Typically, reductions in return are partially offset by payments of reduced income taxes between rate cases. Therefore, adjusting a utility's income tax allowance without reflecting increases in

net plant could overstate the effects of the TCJA on the utility's actual return and tax liability. A general rate proceeding also is the best mechanism for allocating the effects of tax reductions as it provides a detailed allocated cost study including taxes by rate class. For these reasons, the most accurate and appropriate method to adjust for TCJA effects is in a general rate proceeding.

York Water also notes that adjusting rates down on an interim basis followed by a subsequent general rate increase would exacerbate the apparent increase to customers when the general rate case is implemented as compared to reflecting all of the changes to taxable income and income taxes as part of the general rate increase in one set of rate changes. Utilities that have accelerated construction programs are highly likely to file base rate proceedings in 2018 or 2019 because continuing plant investments erode return.¹ The Commission should defer any action with regard to the effects of the TCJA for any utility that files a general rate proceeding in the near future.

If a utility does not file a general base rate proceeding in the near future, a mechanism which provides for a reduction in base rates may be implemented under appropriate circumstances. The lawful and appropriate method for passing back the effects of a reduced tax obligation is by implementing temporary rates under Section 1310 of the Public Utility Code. Attachment C to the Commission's Secretarial Letter allows utilities to update revenues and expenses. In addition to the data requested in Attachment C, utilities should be permitted to provide information that will permit the Commission to reflect the effects of increased net rate base, depreciation and the required additional return in calculating any base rate adjustment. Base rates should not be changed retroactively as

¹ While the DSIC mitigates this erosion of return with respect to eligible plant, the 5% cap on revenues that may be recovered through the DSIC effectively dictates that most utilities file for base rate relief every few years.

such rates were previously determined to be just and reasonable, based on all costs, so any rate change should be implemented only prospectively. Any revenue decrease should be allocated as an equal percentage reduction to base rates of all classes.

Q. 3. If any of the potential tax savings from the reduced federal corporate tax rate can be used for purposes other than to reduce rates, provide details on how and where those tax savings can be used.

A. 3. Prior to the implementation of TCJA, companies were able to charge customers for taxes at the 34% rate on the difference between book depreciation and federal accelerated tax deduction and retain that differential until book depreciation exceeded accelerated tax depreciation (deferred taxes). The recovery of deferred taxes created a significant source of funds for investment in utility plant. The TCJA will reduce the availability of deferred taxes in two ways. First, by the lowering of the federal tax rate from 34% to 21% and, second, by removing provisions for bonus depreciation for utilities. Companies should be permitted to make proposals to use the reductions in federal taxes to fund plant additions in lieu of reflecting such reductions by lowering base rates.

Q. 4. Does the company have any Net Operating Losses (NOL) as of 12/31/17? Please quantify the impact of the Tax Cuts and Jobs Act (TCJA).

A. 4. York Water does not have Net Operating Losses (NOL) as of December 31, 2017.

Q. 5. Does the company have any Deferred Tax Liabilities as of 12/31/17? Please quantify the impact of the Tax Cuts and Jobs Act (TCJA).

A. 5. York Water had a deferred tax liability related to accelerated depreciation as of December 31, 2017. Under normalization rules applicable to public utility property included in the TCJA, the excess accumulated deferred income taxes on accelerated

depreciation from lowering of the enacted federal statutory corporate tax rate was recorded as a regulatory liability as of December 31, 2017. The amount was approximately \$14.3 million. The excess will be reflected in rates in future rate cases determined in accordance with the TCJA. The remainder of the deferred tax assets and liabilities were remeasured at the lower federal statutory corporate tax rate and the effect was recognized in net income for 2017 as the resulting deferred income taxes on those deferred tax assets and liabilities are not recognized for rate making purposes.

Q. 6. Are there any impacts on riders/surcharges resultant from the TCJA? If so, please explain.

A. 6. Under the recommendation that the Commission should defer any action with regard to the effects of the TCJA for any utility that files a general rate proceeding in the near future, the lower tax rate may impact future distribution system improvement charge filings.

Q. 7. Are there any other changes made in the TCJA that will impact the company? If so, please explain.

A. 7. The domestic production deduction has been repealed for tax years after 2017. This will increase the current income tax expense of the Company partially offsetting the effect of the lower federal statutory corporate tax rate. Before the TCJA, water and wastewater contributions in aid of construction were not subject to income tax. Under the TCJA, this exception was removed so that water and wastewater contributions in aid of construction are subject to income tax resulting in an increase to the current income tax expense of the Company partially offsetting the effect of the lower federal statutory corporate tax rate.

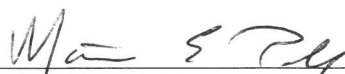
The elimination of bonus depreciation will slow the growth of the accumulated deferred income taxes which will grow rate base over the long term.

- Q. 8. What test year should be used to quantify the new the 21% federal corporate tax rate to be effective 1/1/18?
- A. 8. Under the recommendation that the Commission should defer any action with regard to the effects of the TCJA for any utility that files a general rate proceeding in the near future, York Water recommends that the new federal corporate tax rate should be reflected in the test year used for setting new base rates in the next rate case filed by the Company.
- Q. 9. Please provide the following information regarding your last Commission approved rate case:
- a. Docket Number: R-2012-2336379
 - b. Date filed: May 29, 2013
 - c. Approved Rate of Return: Settled; requested 8.63% rate of return in filing
 - d. Approved Increase in Annual Revenues: \$4,972,040 in additional water revenue and \$27,960 in additional wastewater revenue
 - e. Allocation of Approved Increase Among Major Customer Classes: See attached
 - f. Effective Date of new rates: March 1, 2014

VERIFICATION

I, Matthew E. Poff, hereby state that the facts above set forth are true and correct to the best of my knowledge, information and belief, and that I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).

Date: March 9, 2018



Matthew E. Poff
Chief Financial Officer
The York Water Company

THE YORK WATER COMPANY

COMPARISON OF PRO FORMA COST OF SERVICE WITH REVENUES UNDER PRESENT AND SETTLEMENT RATES
FOR THE TWELVE MONTHS ENDED FEBRUARY 28, 2015

Customer Classification (1)	Pro Forma Revenues, 12 Months Ending 2/28/2015 Under Present Rates* (4)		Under Settlement Rates (5)		Under Settlement Rates (6)		Settlement Increase (7)		Settlement Increase (8)		Settlement Increase (9)	
	Amount (Schedule J)	Percent of Total	Amount (Schedule K)	Percent of Total	Amount (Schedule K)	Percent of Total	Amount	Percent	Amount	Percent	Amount	Percent
Residential												
Gravity	\$ 7,909,716	19.5%	\$ 8,917,932	19.5%			\$ 1,008,216	12.7%				
Repumped	17,755,213	43.6%	20,017,603	43.8%			2,262,390	12.7%				
Total	25,664,929	63.1%	28,935,535	63.3%			3,270,606	12.7%				
Commercial												
Gravity	3,132,259	7.7%	3,520,891	7.7%			388,632	12.4%				
Repumped	5,725,966	14.1%	6,434,258	14.1%			708,292	12.4%				
Total	8,858,225	21.8%	9,955,149	21.8%			1,096,924	12.4%				
Industrial												
Gravity	850,041	2.1%	966,375	2.1%			116,334	13.7%				
Repumped	2,411,670	5.9%	2,741,538	6.0%			329,868	13.7%				
Total	3,261,711	8.0%	3,707,913	8.1%			446,202	13.7%				
Private Fire												
Gravity	696,074	1.7%	696,074	1.5%			-	0.0%				
Repumped	1,009,087	2.5%	1,102,938	2.4%			93,851	9.3%				
Total	1,705,161	4.2%	1,799,012	3.9%			93,851	5.5%				
Public Fire												
Gravity	252,226	0.6%	256,090	0.6%			3,864	1.5%				
Repumped	951,153	2.3%	1,004,376	2.2%			53,223	5.6%				
Total	1,203,379	2.9%	1,260,466	2.8%			57,087	4.7%				
Total Sales	\$ 40,693,405	100.0%	\$ 45,658,075	99.9%			\$ 4,964,670	12.2%				
Other Revenue	590,242		597,492				7,250	1.2%				
Total	\$ 41,283,647		\$ 46,255,567				\$ 4,971,920	12.0%				

* Present base rate revenue from Schedule J (excludes DSIC and STAS surcharges).

The York Water Company

Calculation of State and Federal Income Taxes

Line No.	DESCRIPTION	Last Commission Approved Rate Case	Actual Results 12/31/17	Ratemaking Adjustments	Proposed Adjusted 12/31/17
1	Operating Revenues	\$	48,589,198 \$	(385,511) \$	48,203,687
2	Less: O&M Expenses		19,347,392	1,461,940	20,809,332
3	Book Depreciation		6,768,927	692,906	7,461,833
4	Interest Expense		5,348,256	14,579	5,362,835
	Operating Income before Taxes Total	\$ -	17,124,623 \$	(2,554,936) \$	14,569,687
6	Add: Premature Property Losses/ Amortizations				
7	Depr- Straight Line- Remaining Life (Incl COR)	\$	6,768,927 \$	692,906 \$	7,461,833
8	Taxable Meals & Entertainment	\$	918	\$	918
9	Total	\$ -	6,769,845 \$	692,906 \$	7,462,751
	Deduct				
10	State Tax Depreciation		12,585,979	(735,130)	11,850,849
11	MACRS On Post 1986 Assets				
12	Cost of Removal		2,088,371		2,088,371
13	Total	\$ -	14,674,350 \$	(735,130) \$	13,939,220
14	State Taxable Income	\$ -	9,220,118 \$	(1,126,900) \$	8,093,218
15	State Income At:				
16	Historic, Future and Fully Projected At 9.99%	\$ -	921,090 \$	(112,577) \$	808,512
17	Taxable Income after State Income Tax	\$ -	8,299,028	(1,014,323)	7,284,706
18	Add: Cost Of Removal Non ADR Property				
19	ACRS On Post 1980 Assets				
20	MACRS On Post 1980 Assets- State				
	Deduct: SLRL-ON-POST-1980-ASSETS-& AMORTIZATION-				
21	Additional Federal Tax Depreciation		4,539,833	(2,817,038)	1,722,795
22	Income Subject To Federal Income Tax	\$ -	3,759,195 \$	1,802,715 \$	5,561,911
23	Federal Income Tax at 35% 34%	\$ -	1,278,126 \$	612,923 \$	1,891,050
24	Federal Income Tax at 21%	\$ -	789,431 \$	378,570 \$	1,168,001

The York Water Company was subject to the 34% federal tax rate, not 35%. This schedule was adjusted to reflect that fact.

Effect of Tax Cuts and Jobs Act (TCJA) on Rates

<u>Pre TCJA Taxes</u>	<u>Net Tax Effect</u>
Federal- Current (Page 1, Column 4, Line 23)	\$ 1,891,050.00
Federal- Deferred	\$ 1,428,062.00
<u>Less: Post TCJA Taxes</u>	
Federal- Current (Page 1, Column 4, Line 24)	\$ 1,168,001.00
Federal- Deferred	\$ 882,038.00
Effect of TCJA On Income (A)	\$ 723,049.00
Change in ADIT	\$ 546,024.00
Commission Approved Rate of Return	8.63%
Effect of ADIT Change on Income (B)	\$ 47,121.87
Earnings Excess (Line A - Line B)	\$ 675,927.13
Complement of Tax Rate	0.711079
Revenue Excess	\$ 950,565.45
Commission Allowed Revenues	\$ 46,395,188.00
Percent Decrease Per Bill	-2.0488%