

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**DOCKET NOS. R-2021-3027385, R-2021-3027386**

**AQUA PENNSYLVANIA, INC.  
AQUA PENNSYLVANIA WASTEWATER, INC.**

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**PREPARED REBUTTAL TESTIMONY OF  
CHRISTINE L. SABALL**

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**Topics Addressed:**

**Income Tax Impacts of Repairs Deduction  
Uncertain Tax Positions  
Income Tax Impacts of Interest Synchronization  
Federal Income Tax Rider**

DATE SERVED: December 2, 2021  
DATE ADMITTED: \_\_\_\_\_

**Aqua Statement No. 8-R**

1 **I. INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. Christine L. Saball. My business address is 762 W. Lancaster Avenue, Bryn Mawr,  
4 Pennsylvania 19010.

5

6 **Q. Did you previously submit testimony in this proceeding on behalf of Aqua**  
7 **Pennsylvania, Inc. and Aqua Pennsylvania Wastewater, Inc. (“Aqua PA,” “AP” or**  
8 **the “Company”)?**

9 A. Yes. I submitted my direct testimony, AP Statement No. 8, on August 20, 2021.

10

11 **Q. What is the purpose of your rebuttal testimony?**

12 A. My testimony responds to certain portions of the direct testimony submitted by the  
13 Pennsylvania Public Utility Commission’s (“Commission”) Bureau of Investigation and  
14 Enforcement (“I&E”), and the Office of Consumer Advocate (“OCA”).

15 Specifically, I will be responding to the following pieces of testimony and the  
16 identified issues raised therein:

- 17 • OCA Statement No. 1, the direct testimony of Ralph Smith, regarding the income  
18 tax impacts of repair deductions, uncertain tax positions and interest  
19 synchronization.
- 20 • I&E Statement No. 1, the direct testimony of Christine Wilson, regarding the  
21 Federal Tax Adjustment Surcharge.
- 22 • OCA Statement No. 2, the direct testimony of Morgan N. DeAngelo, regarding the  
23 Federal Tax Adjustment Surcharge.

1 **Q. Are you sponsoring any exhibits associated with your rebuttal testimony?**

2 A. No

3

4 **II. TAX REPAIRS DEDUCTION**

5 **Q. How does Aqua PA reflect the deduction for tax repairs for ratemaking purposes?**

6 A. As I explained in my direct testimony, the Company uses “flow-through” accounting to  
7 compute the benefits of the tax repair deduction for ratemaking purposes. The Company  
8 also has in place a Collar mechanism that establishes a regulatory asset or liability if the  
9 net deduction between rate cases falls outside a range of \$3 million below or above the  
10 target deduction amount. The use of “flow-through” accounting and the Collar mechanism  
11 were established in the Settlement of the Company’s 2018 Base Rate Case.

12

13 **Q. Has any party challenged the use of “flow-through” accounting?**

14 A. No party has proposed any change to the use of “flow-through” accounting. However,  
15 OCA Witness Smith does refer to the use of “normalization” accounting as an alternative  
16 approach to account for tax repairs for ratemaking purposes. OCA Statement No. 1, p. 31.

17

18 **Q. Do you have any comment regarding normalization accounting?**

19 A. Yes. The Internal Revenue Code requires the normalization of the difference between book  
20 depreciation and tax depreciation, otherwise referred to as method life differences. The  
21 code does not require normalization of basis differences between book assets and tax  
22 assets. Flow-through accounting is available to utility companies to synchronize the  
23 Company’s tax payments to the IRS and the inclusion of tax expense in the revenue  
24 requirement when not restricted by the normalization rules. The use of flow-through

1 accounting is an acceptable practice in Pennsylvania and is utilized by many utilities. In  
2 addition, I have been advised by counsel that normalization of the tax repair deduction may  
3 be contrary to Pennsylvania law, as interpreted by Pennsylvania courts.

4  
5 **Q. What tax repair deduction has Aqua PA claimed for the FPFTY?**

6 A. The Company has included a net total repair deduction of \$159,060,000 in the FPFY. This  
7 is inclusive of both water and wastewater segments. The Company has also proposed to  
8 continue the practice of recording a collar on the repair deduction. If the net repairs  
9 deductions for Aqua PA vary by more than \$3 million above or below the \$159,060,000  
10 amount (i.e., above \$162,060,000, or below \$156,060,000), Aqua PA will record a  
11 regulatory liability or asset for the related income tax expense impacts of the repair  
12 deduction variations above \$162,060,000 or below \$156,060,000.

13  
14 **Q. Has any party proposed a change to the tax deduction for repairs?**

15 A. Yes. OCA Witness Smith proposes to increase the deduction for tax repairs to \$167.3  
16 million. As claimed by Mr. Smith, this would reduce the Company's state and federal  
17 income tax expense by approximately \$2.38 million at present rates. OCA Statement No.  
18 1, p.32.

19  
20 **Q. What is the basis for Mr. Smith's claimed adjustment to the tax repair deduction?**

21 A. Mr. Smith states that he relied upon the Company's response to OCA Set X – 27, which he  
22 asserts updated the tax repair deduction to \$167.3 million.

1 **Q. Did the Company’s response to OCA-X-27 propose to change the Company’s claimed**  
2 **tax repair deduction for the FPFTY?**

3 A. No. OCA-X-27 requests the detail of the repair deduction for tax year 2021. In the  
4 Company’s original filing, the estimated repair deduction for the 2021 tax year was \$163.5  
5 million. After the original filing, the Company updated its estimated repair deduction for  
6 the 2021 tax year to \$167.3 million.

7 The Company claims a deduction for repairs on its tax return based on the date the  
8 related book asset is put into service, which can result in year over year fluctuations as  
9 property is put into service. The final analysis for the repair deduction claimed on the  
10 Company’s tax returns is completed in conjunction with the filing of the Federal Form  
11 1120, in the fourth quarter of the year. In the fourth quarter of 2021, the Company  
12 determined that the net amount of repairs deductible on the 2020 tax return is \$150.4  
13 million. The Company recorded a regulatory asset for the income tax impact of the repair  
14 deduction below the collar prescribed in the 2018 base rate case. The increase in estimated  
15 deductible repairs on the 2021 tax return is a result of analysis of the timing of capital spend  
16 versus in service dates **and is not indicative** of a level of future deductions. Instead, it is  
17 an offset to the 2020 shortfall and is expected to offset the regulatory asset imposed by the  
18 collar calculation, thus reducing recovery necessary from customers.

19 The Company based its projection of deductible repairs included in the FPFTY by  
20 considering capital requirements for the immediate future, as well as historical data such  
21 as qualifying repair factors and resource constraints, as shown in the below table.  
22  
23

| <b>Repair Est. Based on (Capital Budget - Spend)</b> | <b>1st Yr. Rates<br/>2022</b> | <b>2nd Year Rates<br/>2023</b> | <b>3rd Year Rates<br/>2024</b> | <b>3 year Average</b> |
|--|-------------------------------|--------------------------------|--------------------------------|-----------------------|
| Estimated RTC Capital Spend                          | \$168,836,249                 | \$159,446,960                  | \$159,992,972                  | \$162,758,727         |
| Less Estimated AFUDC                                 | -1,440,000                    | -1,440,000                     | -1,440,000                     | -\$1,440,000          |
| Less Estimated FIN48                                 | -4,000,000                    | -4,000,000                     | -4,000,000                     | -\$4,000,000          |
| <b>Net Repair Benefit (Collar)</b>                   | <b>\$163,396,249</b>          | <b>\$154,006,960</b>           | <b>\$154,552,972</b>           | <b>\$157,318,727</b>  |

| <b>Repair Est (As Filed)</b>       | <b>1st Yr. Rates<br/>2022</b> | <b>2nd Year Rates<br/>2023</b> | <b>3rd Year Rates<br/>2024</b> | <b>3 year Average</b> |
|------------------------------------|-------------------------------|--------------------------------|--------------------------------|-----------------------|
| Estimated RTC Capital Spend        | \$164,500,000                 | \$164,500,000                  | \$164,500,000                  | \$164,500,000         |
| Less Estimated AFUDC               | -1,440,000                    | -1,440,000                     | -1,440,000                     | -\$1,440,000          |
| Less Estimated FIN48               | -4,000,000                    | -4,000,000                     | -4,000,000                     | -\$4,000,000          |
| <b>Net Repair Benefit (Collar)</b> | <b>\$159,060,000</b>          | <b>\$159,060,000</b>           | <b>\$159,060,000</b>           | <b>\$159,060,000</b>  |

The Company notes that the update to the 2021 estimated repair deduction does not represent a normal recurring level of repairs deductions as indicated by Witness Smith in OCA St, 1 at 33. Witness Smith acknowledges that the repair deduction used in the income tax calculation for the FPFTY income taxes should reflect the amount expected to be deducted for repairs (OCA St. 1 at 33). Although we disagree on the treatment of the reserve for uncertain tax positions, as discussed below, the Company agrees that in the income tax calculation for the FPFTY income taxes should reflect the amount expected to be deducted for repairs. The Company asserts that the update to the 2021 estimated deduction has no impact on the FPFTY and the Company’s estimated net repair deduction included in the FPFTY remains at \$159,060,000, therefore resulting in no adjustment to the Company’s claimed income tax expense related to the repair deduction.

It should be noted that if the Company did incur a higher level of spend that qualified for a repair deduction, as Witness Smith contends, the Company has proposed the continuation of the collar mechanism. Therefore, if the net repairs deductions for Aqua PA exceed \$162,060,000, Aqua PA will record a regulatory liability for the related income tax benefit for the amount over \$162,060,000.

1 **Q. OCA Witness Smith also opposes the Company’s netting of the provision for**  
2 **uncertain tax positions (“FIN 48”) in computing its tax repair deduction. OCA St. 1**  
3 **at 32-34. Please comment.**

4 A. I disagree with Witness Smith’s assertion that the estimated income tax benefit related to  
5 the tax repair deduction should not be reduced by the provision for uncertain tax positions.  
6 As I explained in my response to OCA-IV-33, the Company routinely assesses the need  
7 for a provision for uncertain tax positions. Tax positions are first evaluated as to whether  
8 it is more likely than not it will be sustained upon examination, including resolution of any  
9 related appeals or litigation processes, based on the technical merits of the position. Tax  
10 positions are then evaluated to determine the benefit to recognize in the financial  
11 statements, which is the largest amount of tax benefit that is greater than 50 percent likely  
12 of being realized upon ultimate settlement. As of the date of this filing, the IRS has not  
13 issued guidance regarding the repair deduction for the water industry and there is no audit  
14 history related to this issue. If disallowed, the resulting audit adjustment would be  
15 calculated on all historical deductions as the Company is put on a deemed permissible  
16 method. It would be imprudent to pass an income tax benefit to customers that has not met  
17 the threshold for financial statement recognition, and in Aqua’s 2018 base rate case, the  
18 OCA did not oppose the inclusion of a reserve for uncertain tax positions in the calculation  
19 of the estimated income tax benefit.

20 If the income tax benefit is not reduced by the reserve for the uncertain tax position,  
21 and the tax position is subsequently audited and disallowed, the Company would record a  
22 regulatory asset to recover the disallowed benefit that has been included in customer rates.  
23 If the tax position is subsequently audited and the position is partially or wholly sustained,

1 the net reversal of the uncertain tax position will be returned to customers to the extent it  
2 was included in customer rates. By including the reduction for uncertain tax position in  
3 current rates, the benefit from the uncertain tax position is normalized to mitigate the risk  
4 of disallowance.

5 During the course of preparing my rebuttal testimony I realized I inadvertently  
6 omitted \$3.4 million of accumulated deferred income tax on uncertain tax positions that  
7 would have reduced the Company's rate base. The Company will update its exhibits  
8 accordingly.

9 Considering my above statement, if the repair deduction is adjusted to reflect the  
10 amount estimated to be claimed on the Company's tax return, the adjustments must also be  
11 made to deferred tax liabilities in the rate base calculation and deferred tax expense in the  
12 cost of service calculation.

13 It is the Company's position that the benefit of the repair deduction be reduced by  
14 the estimated reserve for uncertain tax positions in the ratemaking income tax calculations,  
15 which is consistent with the treatment in the 2018 rate case settlement and in the  
16 Company's as filed case exhibits in this proceeding. Mr. Smith's proposal to remove the  
17 FIN 48 adjustment should be rejected.

18  
19 **Q. OCA Witness Smith proposes an adjustment to tax expense for Interest**  
20 **Synchronization. OCA St. 1 at 34. Please comment.**

21 A. Witness Smith has proposed adjustments based upon OCA's proposed changes to the  
22 capital structure of the Company. While I do not disagree with the calculation of the impact  
23 on tax expense of the interest expense adjustment, it should be acknowledged that the



1 Company disagrees with the OCA’s proposed change to the Company’s capital structure,  
2 therefore making OCA’s recommended adjustment to the tax expense for purposes of  
3 interest synchronization unnecessary.  
4

5 **III. FEDERAL TAX ADJUSTMENT SURCHARGE**

6 **Q. Please explain Aqua PA’s Federal Tax Adjustment Surcharge proposal.**

7 A. Aqua PA is proposing to add the revenue requirement for the incremental impact of a  
8 change in the federal corporate income tax rate to its water and wastewater tariffs, named  
9 the Federal Tax Adjustment Surcharge (“FTAS”). The FTAS is designed to provide for  
10 adjustments to base rates reflecting the effects of future increases or decreases in the federal  
11 corporate income tax rate.  
12

13 **Q. Please summarize I&E Witness Wilson’s (I&E St. 1 at 34-36) and OCA Witness  
14 DeAngelo’s (OCA St. 2 at 15-16) opposition to the Company’s proposed FTAS.**

15 A. I&E Witness Wilson recommends that the Company’s proposed FTAS Rider be  
16 disallowed on the basis that the Company cannot say with any certainty if/when an increase  
17 to the federal corporate income tax rate will take effect. Ms. Wilson also contends that the  
18 Commission’s experience dealing with the Tax Cuts and Jobs Act (“TCJA”) will result in  
19 adequate and timely guidance on a statewide basis following a change in federal corporate  
20 income tax rates, and that the Company’s should be required to await such guidance.  
21 Additionally, I&E Witness Wilson argued that the FTAS Rider should not allow rate  
22 adjustments via the proposed surcharge mechanism for impacts associated with deferred  
23 federal income taxes, indicating that the proposed FTAS Rider should only be allowed for

1 the *current* Federal income tax expense portion of the change.

2 OCA Witness DeAngelo also recommended that the Company's proposed FTAS  
3 Rider should not be approved on the basis that it is uncertain when the next change in the  
4 corporate tax rate will occur and such change should be addressed by the Commission on  
5 a generic basis for all public utilities.

6  
7 **Q. Do you agree with Ms. Wilson's and Ms. DeAngelo's conclusions?**

8 A. No, I do not. Regarding Ms. Wilson's and Ms. DeAngelo's conclusion that a federal  
9 corporate rate tax is speculative or uncertain, the President and his administration has  
10 repeatedly referenced an increase in the rate as a critical part of his agenda. I fully agree  
11 that no one can say with any certainty if/when an increase to the federal corporate income  
12 tax rate will take effect. A change in the Federal income tax rate will impact all utilities at  
13 the same time and such change may impact whether a utilities' existing rates are no longer  
14 "just and reasonable," as required by Pennsylvania law. The purpose of the FTAS Rider is  
15 to function as a temporary mechanism if/when an increase or decrease in Federal income  
16 tax rates results in existing rates being no longer "just and reasonable". If federal income  
17 tax rates do not change, the FTAS will have no impact on customers. Therefore, even if a  
18 change in federal income tax rates were highly unlikely (which is not the case here), this  
19 would not be a reason to reject the FTAS.

20 Ms. DeAngelo's conclusion that the changes in tax law should be addressed by the  
21 Commission on a generic basis for all public utilities it regulates, disregards the  
22 circumstances of each utility that must be taken into consideration in individual cases by  
23 the Commission. In Witness DeAngelo's testimony, she acknowledges that provisions

1 included in TCJA need to be given consideration (OCA St. 2 at 15-16), yet fails to  
2 acknowledge that tax provisions need to be analyzed as they apply to an individual utilities  
3 circumstances therefore a generic order could not accurately adjust rates for all utilities.  
4

5 **Q. Please respond to Ms. Wilson's contention that the Commission can be expected to**  
6 **respond in a timely manner on a state-wide basis if there is a significant increase in**  
7 **the federal corporate income tax rate.**

8 A. Ms. Wilson cites the Commission's response to the 2018 decrease in the federal corporate  
9 income tax rate under the TCJA. Ms. Wilson provides no example where the Commission  
10 has so responded to an increase in the federal corporate tax rate. The situations may be  
11 construed differently by the Commission in the face of significant increases in tax rates  
12 and increases in customers' rates. The Commission could take the position that the effects  
13 of any federal tax rate increase must be recovered in a base rate case and only prospectively.  
14 If the Commission takes this position, the Company would be compelled to file a base rate  
15 case, which is both costly and time consuming.  
16

17 **Q. Ms. Wilson further asserts that, if the FTAS is approved, that it be revised to exclude**  
18 **effects on deferred federal income taxes. I&E St. 1 at 35-36. Please respond.**

19 A. In addition to the impact of the tax rate change on current Federal income tax expense,  
20 protected excess deferred federal income taxes must be included in the FTAS calculation  
21 if approved. Excess deferred taxes are taxes recorded at a tax rate higher than the current  
22 rate and are returned to customers in this proceeding over the remaining book life of the  
23 underlying assets. If the federal corporate tax rate increases, the excess deferred taxes

1 automatically decrease, but the term for returning them does not change. The calculation  
2 of the change would be provided with the FTAS filing and subject to reconciliation and  
3 subsequent audit under the FTAS. Continuing to amortize excess deferred taxes based on  
4 a revised and substantially reduced balance would be inappropriate and potentially violate  
5 federal tax requirements that require the return of deferred taxes using average rate  
6 assumption method. Any further changes, including the treatment of excess deferred taxes  
7 on unprotected items, can be addressed in the next base rate proceeding.

8  
9 **IV. OTHER CHANGES TO INCOME TAX EXPENSE**

10 **Q. Ms. Saball, certain changes to revenues and expenses proposed by other parties’  
11 witnesses affect the Company’s pro forma income tax expense. Please comment.**

12 **A.** The Company opposes these income tax revisions to the extent it opposes the underlying  
13 revenue and expense adjustments, which are addressed by other company witnesses.

14  
15 **V. CONCLUSION**

16 **Q. Does this conclude your rebuttal testimony?**

17 **A.** Yes, it does.