

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Docket No. R-2024-3046523**

**Duquesne Light Company**

**Statement No. 10**

**Direct Testimony of Matthew L. Simpson**

**Subject: Taxes**

**Dated: March 20, 2024**



1 A. I am a Certified Public Accountant and an active member of both the American  
2 Institute of Certified Public Accountants and Pennsylvania Institute of Certified  
3 Public Accountants. Prior to joining Duquesne Light, I held the position of Tax  
4 Director at a large multi-national construction company headquartered in  
5 Pittsburgh, PA. Before joining private industry, I held various positions in public  
6 accounting firms where I managed compliance and advisory services for clients in  
7 various industries, including the energy, construction, and manufacturing sectors. I  
8 hold a Bachelor of Science Degree in Accounting from Penn State University as  
9 well as a Master of Science Degree in Taxation that I received from Robert Morris  
10 University in Pittsburgh.

11

12 **Q. Have you previously testified before this or any other regulatory agency?**

13 A. Yes. I provided written testimony to the Pennsylvania Public Utility Commission  
14 for Duquesne Light Company's 2013, 2018 and 2022 distribution rate filings,  
15 Docket Nos. R-2013-2372129, R-2018-3000124 and R-2021-3024750. I have also  
16 provided written testimony to the Federal Energy Regulatory Commission, Docket  
17 No. ER13-1220-000 and Docket No. ER21-1012-000, related to a Monthly  
18 Deferred Tax Adjustment charge.

19

20

21 **Q. What is the purpose of your direct testimony?**

22 A. The purpose of my testimony is to describe and explain Duquesne Light's income  
23 tax expense and other tax expense included in the cost of service. The filing

1 includes federal and state income tax recovery, reduction of rate base for deferred  
2 income taxes and incorporation of the effects of the enacted Tax Cuts and Jobs Act  
3 of 2017 initially addressed in the Company's 2018 distribution rate case, Docket  
4 No. R-2018-3000124.

5  
6 **Q. Are you sponsoring any exhibits as part of your direct testimony?**

7 A. Yes, I am. I am co-sponsoring Duquesne Light's Income Statement as it relates to  
8 taxes and the Balance Sheet as it relates to deferred and prepaid taxes. The specific  
9 schedule references are DLC Exhibit 2 (FPFTY), Exhibit 3 (FTY) and Exhibit 4  
10 (HTY), Schedules B-1, B-2, B-5, C-6, D-20 and D-22. I am sponsoring all the Data  
11 Filing Requirements and Schedules concerning Taxes. Please see Exhibit MLS-1  
12 to my testimony for the listing of data filing requirements that I am sponsoring. My  
13 name is at the top of each data filing requirement that I sponsor.

14

15 **Q. Please explain how these exhibits were prepared?**

16 A. All were prepared either by me or under my direction or supervision. They were  
17 prepared in accordance with Commission requirements and Internal Revenue  
18 Service procedures and guidance.

19

## II. TAX CALCULATIONS

20

### A. INCOME TAXES

21 **Q. Please discuss the Company's claim for income taxes.**

22 A. Income taxes are calculated using the procedures normally followed by the  
23 Commission, including the use of debt interest synchronization, the flow through

1 of accelerated tax depreciation and other accelerated tax deductions when  
2 computing current state income taxes, and the normalization method for accelerated  
3 depreciation used in the calculation of Federal income taxes.

4

5 **Q. Could you explain Duquesne Light's income tax expense for the HTY?**

6 A. For the HTY the Company has used its December 31, 2023 financial statement  
7 information to calculate its current and deferred income tax expense. The tax  
8 expense calculations were made in accordance with federal and state laws, using a  
9 federal income tax rate of 21% and a Pennsylvania income tax rate of 8.99%.

10

11 **Q. Could you explain the Company's income tax expense calculation for the  
12 FPFTY and FTY?**

13 A. The calculation of federal and state income tax expense is reflected on Schedule D-  
14 22 within DLC Exhibit 2 (FPFTY) and DLC Exhibit 3 (FTY). These calculations  
15 begin with revenue at present and pro forma rates, reduced by operating expenses  
16 at present and pro forma rates and further reduced by synchronized interest expense  
17 to arrive at base taxable income on line 7. The synchronized interest expense  
18 deduction is calculated by multiplying the average debt cost times the debt ratio  
19 times the rate base to synchronize the interest deduction to the portion of the rate  
20 base financed by debt. State tax deductions related to property are made to arrive  
21 at state taxable income on line 16. The statutory state corporate net income tax rate  
22 in effect for the applicable test year (FPFTY is 7.99% and FTY is 8.49%) was then  
23 applied to compute the pro forma state income tax expense shown on line 17. To

1 compute current federal income tax expense, the base taxable income on line 7 was  
2 reduced by the calculated current state income tax expense on line 17 and by the  
3 federal tax deductions related to property shown on lines 18 through 25 to arrive at  
4 the federal taxable income shown on line 26. The Company applied the current  
5 federal statutory corporate tax rate of 21% to compute the pro forma current federal  
6 income tax expense shown on line 27. Federal deferred income taxes on lines 31  
7 and 32 were also computed at the current federal statutory corporate tax rate of  
8 21%. In addition, the deferred income tax expense calculation was reduced to  
9 reflect the flow back of excess deferred income taxes (EDIT) due to the reduction  
10 in the federal corporate income tax rate from 35% to 21% as per the TCJA. No state  
11 deferred income taxes have been reflected as the tax benefits of accelerated  
12 deductions are flowed through to customers.

13

14 **Q. Please describe the Company's use of accelerated tax depreciation methods in**  
15 **computing its federal tax depreciation?**

16 **A.** The Company uses accelerated depreciation. From 1971 to 1980 the Company  
17 elected to calculate tax depreciation under the provisions of the Class Life Asset  
18 Depreciation Range ("ADR") as provided by the Revenue Act of 1971. From 1981  
19 to 1986 the Company elected to calculate tax depreciation under the Accelerated  
20 Cost Recovery System ("ACRS") as provided by the Economic Recovery Tax Act  
21 of 1981. From 1987 to the present the Company has elected to calculate tax  
22 depreciation under the provisions of the Modified Accelerated Cost Recovery  
23 System ("MACRS") as originally provided by the Tax Reform Act of 1986 and as

1 modified in subsequent Acts. Prior to 2018, the tax law allowed for additional bonus  
2 depreciation deductions. However, with the enactment of the TCJA, regulated  
3 utilities are no longer permitted to take bonus depreciation in computing their  
4 annual accelerated tax depreciation deductions.

5  
6 **Q. Please comment on the deferred income taxes of accelerated depreciation**  
7 **presented in your tax expense.**

8 A. In this rate case, Duquesne Light is reflecting deferred income taxes resulting from  
9 the adherence to IRS normalization rules and use of accelerated federal tax  
10 depreciation associated with Post -1969 Public Utility Property under the following  
11 depreciation methods: General Depreciation Rules (pre-1971), Class Life ADR  
12 (1971-1980), ACRS (1981-1986), MACRS (1987-Present).

13 Duquesne Light's continued entitlement to the use of accelerated  
14 depreciation provision on Post -1969 Public Utility Property for federal income tax  
15 purposes is dependent upon the use of a normalization method of accounting for  
16 the resulting deferred income tax activity in determining cost of service (and total  
17 accumulated deferred tax balance used in rate base) for rate making.

18 The Company computes the deferred income taxes used in the cost-of-  
19 service calculation based on the applicable Internal Revenue Service ("IRS")  
20 normalization regulations which are primarily based on the original in-service date  
21 of the underlying asset. Duquesne Light follows guidance within former IRC  
22 Section 167(1) and IRC Section 168(i)(9) in which depreciation timing differences  
23 of federal accelerated tax depreciation in excess of the straight-line depreciation

1 using the method for calculating the ratemaking depreciation is tax effected at the  
2 current federal tax rate. This is implemented by calculating the income tax on the  
3 difference between accelerated depreciation and straight line or book depreciation  
4 and charging that tax to customers as deferred income taxes. This amount is then  
5 added to the accumulated deferred income tax (ADIT) balance, which is deducted  
6 from rate base to give customers the benefit of the advance payment of the taxes.  
7 When these underlying depreciation timing differences reverse, the customers pay  
8 only the taxes based on the higher book depreciation deduction and the ADIT  
9 balance is reduced as the Company pays higher taxes to the IRS. Absent  
10 normalization accounting for ratemaking purposes, Duquesne Light would be  
11 required to use a straight-line method with book lives in determining its  
12 depreciation allowance for federal income tax purposes.

13 In accordance with Commission policy, the benefits of accelerated tax  
14 depreciation related to pre-1970 Public Utility Property and state income taxes are  
15 flowed through to customers.

16

17 **Q. Would you explain the treatment of cost of removal in the income tax**  
18 **calculation?**

19 A. In determining the pro forma operating expenses for the cost of service, the  
20 customer is charged with removal costs of retired plant through the net negative  
21 salvage adjustment. The customer is also entitled to receive the benefit of any  
22 reduction of income taxes which results from including this adjustment in the pro  
23 forma income tax calculation. Thus, the current tax deduction for cost of removal,

1 net of salvage, has been reflected as a flow-through benefit to the rate payers in  
2 each of the test years.

3

4 **Q. Are there other items treated as flow-through in the rate-making process used**  
5 **to determine income tax expense?**

6 A. Yes. Based on prior Commission orders, the income tax and thus rate-reducing  
7 benefits of the following items have been flowed through to current ratepayers: (1)  
8 the state tax effect of timing differences related to book versus state tax method and  
9 life depreciation differences on all vintaged property; (2) the federal tax effect of  
10 the cumulative timing differences related to book versus federal tax method and life  
11 depreciation differences on pre-1971 vintaged property before the adoption of Class  
12 Life Asset Depreciation Range (“CLADR”); (3) the federal tax effect of the  
13 cumulative timing differences related to the book versus federal tax life on vintage  
14 property during tax years 1971 through 1980, prior to adoption of the Accelerated  
15 Cost Recovery System (“ACRS”) / Modified Accelerated Cost Recovery System  
16 (“MACRS”); (4) the state income tax effects associated with basis differences  
17 between ratemaking balances and the income tax basis of plant; and (5) the federal  
18 and state tax effects of timing differences related to the book versus tax treatment  
19 of cost of removal and salvage.

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21 **Q. Are there any investment tax credits the Company has reflected in the income**  
22 **tax calculations for this rate filing?**

23 A. No.

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B. ACCUMULATED DEFERRED INCOME TAXES

**Q. Please explain how you have accounted for deferred income taxes in this filing.**

A. Federal accumulated deferred income taxes (“ADIT”) related to plant in service are recorded in account 282 and have been deducted from rate base. Consistent with prior rate case filings, it is appropriate to reduce these amounts by the ADIT related to the prepayments on income taxes related to contributions-in-aid of construction. Consistent with my understanding of Commission practices, there is no ADIT balance related to state income taxes on property because the tax benefits of accelerated depreciation are flowed through to customers.

**Q. Please explain the Accumulated Deferred Income Taxes reflected on Schedule C-6?**

A. The ADIT balance at the end of the respective test year reflects the cumulative deferred income taxes on the Company’s property that has been reflected in cost of service, including tax deferrals related to Accelerated Cost Recovery System (“ACRS”) and Modified Accelerated Cost Recovery System (“MACRS”) property. The applicable ACRS/MACRS legislation provides for normalization of federal tax benefits on post-1980 property. In addition, the Company was required by prior rate settlements to normalize the federal tax benefits associated with tax repairs and Section 263A costs related to ACRS/MACRS property. For the fully projected test year ended December 31, 2025, the incremental deferred tax liability arising from

1 items discussed are calculated on a pro rata basis in accordance with Treasury  
2 Regulation Sec. 1.167(l)-1(h)(6)(ii).

3

4 **Q. How has Duquesne Light provided for tax repairs and 263A costs in the HTY,**  
5 **FTY and FPFTY income tax calculations?**

6 A. The 2010 and 2013 Joint Petition for Settlements stipulated that the Company  
7 would normalize the ongoing current tax repairs and 263A deductions for federal  
8 income tax purposes. An estimate of the FTY and FPFTY tax repairs and 263A  
9 deductions were computed based on historical averages. Federal deferred income  
10 taxes were computed on the annual tax repair and 263A deductions, resulting in an  
11 increase to account 282 – ADIT and reducing the Company’s rate base. The state  
12 income tax benefit of the tax repairs and 263A deductions related to distribution  
13 property is being flowed through to the ratepayers.

14

15 **Q. How has the Duquesne Light provided for accumulated deferred income taxes**  
16 **related to the pension rate base adjustment?**

17 A. During Duquesne Light’s 2010 rate case, the Commission adopted a settlement  
18 provision in which the Company would be allowed to include a rate base adjustment  
19 for the portion of the 50% of actual pension contributions that is treated as  
20 capitalized in the ratemaking process over the amount that is actually capitalized to  
21 plant accounts under the SFAS 87 capitalized pension (hereafter referred to as  
22 “Capitalized Pension Adjustment”) from 2007 forward, net of related accumulated  
23 deferred income taxes. The Company has reflected the Capitalized Pension

1 Adjustment amounts as part of its tax plant and has included all tax depreciation  
2 and related ADIT in account 282. The effect is that the offset for tax depreciation  
3 deductions on the increase in tax plant is already reflected in the Account 282 ADIT  
4 deducted from rate base in the Company's test years. The fact that the Commission  
5 is allowing the Company to reflect the Capitalized Pension Adjustment in rate base  
6 does not change (increase or decrease) the tax position required by the IRS and  
7 reflected on the Company's books and tax records. No separate ADIT adjustment  
8 is necessary as the deferred tax impacts of the Capitalized Pension Adjustment are  
9 already included in the Company's 282 Account and reflected in rate base.

10

11 **Q. How did the reduction in the federal income tax rate per the TCJA affect**  
12 **Accumulated Deferred Income Tax (ADIT) balances?**

13 A. Deferred income taxes are recorded to reflect higher income tax payments that will  
14 be paid to the Internal Revenue Service (IRS) when the tax benefits of current  
15 accelerated deductions reverse. As I have explained previously, for ratemaking  
16 purposes utilities use straight line or book depreciation to determine the  
17 depreciation charges that are included in cost of service. For income tax purposes,  
18 utilities can use accelerated tax depreciation methods in computing taxes payable  
19 to the IRS. These large early deductions result in reduced taxes payable during the  
20 early years of an asset's life followed by increases in taxes payable during later  
21 years of the asset's life. Over the asset's life, the same amount of asset deductions  
22 are used in computing the Company's income tax expense; it's just the timing of  
23 these deductions differs between ratemaking and tax reporting. The income tax

1 effect of the book versus tax timing of the asset’s deductions represent a deferred  
2 income tax expense. Deferred income taxes are computed at statutory tax rates,  
3 included in the Company’s income tax expense, and collected from customers as  
4 part of the utility’s cost of service. The cumulative amount of deferred taxes  
5 collected are reflected in account 282 – Accumulated Deferred Income Taxes  
6 (“ADIT”), which is a reduction to the Company’s rate base. As the timing of the  
7 accelerated tax deductions reverse, the Company will pay its deferred income taxes  
8 at 21%, even though it collected deferred income taxes from customers at a higher  
9 tax rate. The difference between the deferred income taxes that will be paid at 21%  
10 versus what has been collected from customers represents excess deferred income  
11 taxes (“EDIT”) that the Company must refund to customers.

12

13 **Q. How are the excess deferred taxes being refunded to customers?**

14 A. The TCJA requires regulated public utilities subject to the normalization method of  
15 accounting to use the average rate assumption method (“ARAM”) to reduce its  
16 excess deferred income tax reserve. Under this method, the excess deferred income  
17 tax reserve is reduced as the timing differences reverse over the remaining life of  
18 the asset and returned as an offset to the annual provision for deferred income taxes  
19 in the cost service calculation in rate proceedings. As stated in the 2018 Joint  
20 Petition for Settlement, the Company is using ARAM to refund the unamortized  
21 EDIT balance recorded in account 282 – Accumulated Deferred Income Taxes and  
22 which have reduced the Company’s rate base. As shown on Exhibit 2, D-22, line

1 30, column 9, the Company has lowered its deferred income tax expense by \$6.755  
2 million for the refund of EDIT to customers in the Fully Projected Future Test Year.

3  
4 C. CONSOLIDATED TAX ADJUSTMENT

5 **Q. Was a Consolidated Tax Adjustment (CTA) included in the income tax**  
6 **expense claim?**

7 A. No. With the passage of Act 40 of 2016, Pennsylvania joins a majority of states  
8 and the federal government in calculating a utility's federal income tax expense on  
9 a standalone basis, so that the recoverable tax expense is based on the utility's  
10 operations, and not on its affiliates. It is my understanding that Act 40, which added  
11 66 Pa. C.S. §1301.1 to the Public Utility Code, prohibits including a CTA to the  
12 Company's income tax expense. However, Section 1301.1(b) also provides that if  
13 a consolidated tax expense differential accrues to the utility resulting from applying  
14 ratemaking methods employed prior the enactment of the Act, then 50% of the  
15 differential shall be used to support reliability or infrastructure construction related  
16 to the utility's rate base, with the other 50% used for general corporate purposes. I  
17 have included a calculation of a CTA adjustment that would have been computed  
18 under prior ratemaking methods in order to identify the differential; which as  
19 explained in the testimony of Mr. Hilderbrand in Statement No. 4, has been used to  
20 support reliability or infrastructure related capital investment. The federal tax rate  
21 of 21% was used in the CTA calculation. See Exhibit MLS-2.

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D. TAXES OTHER THAN INCOME TAXES:

**Q. Explain the PA gross receipts tax and property tax adjustments.**

A. The PA utility gross receipts tax (“GRT”) is levied at the rate of 59 mills (5.9%) on the Company’s taxable gross receipts. This GRT rate is consistently applied throughout the test years. The public utility realty tax (“PURTA”) and locally assessed real estate property taxes were based upon most recent assessments.

III. STATE INCOME TAX RATE CHANGES

**Q. What changes in Pennsylvania tax law have been enacted since the filing of the last rate case?**

A. House Bill 1342 was signed into law in Pennsylvania on July 8, 2022. The bill phases down a reduction to Pennsylvania’s corporate net income tax from 9.99% to 4.99%. The income tax rate was reduced to 8.99% in 2023 and will continue to be reduced to 4.99% by 2031 based on the following phase down schedule:

- 8.49% for tax year 2024
- 7.99% for tax year 2025
- 7.49% for tax year 2026
- 6.99% for tax year 2027
- 6.49% for tax year 2028
- 5.99% for tax year 2029
- 5.49% for tax year 2030
- 4.99% for tax years beginning January 31, 2031, and thereafter.

1

2 **Q. How has the rate reduction been reflected in the income tax calculations in this**  
3 **case?**

4 A. The state income tax expense was computed using the applicable tax rate in effect  
5 for the applicable test year. Based on the phase down schedule, state income tax  
6 expense was calculated based on an 8.99% for the HTY, 8.49% for the FTY and  
7 7.99% for the FPPTY.

8

9 **Q. How will future changes to the state income tax rates be reflected in customer**  
10 **rates?**

11 A. Future changes to the state income tax rates will be managed through the State Tax  
12 Adjustment Surcharge.

13

14 **Q Does this conclude your direct testimony?**

15 A. Yes, it does. I reserve the right to supplement my testimony through the course of  
16 this proceeding.

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<u>Item #</u>	<u>Subject Matter</u>
DFR II-D-14	Debt Interest for Income Tax Calculation
DFR II-D-15	Schedule of Taxes Other than Income
DFR II-D-16	Schedule of Current and Deferred Tax Expense
DFR II-D-17	Schedule of Income Tax Refunds
DFR II-D-18	Prepaid and Deferred Income Tax Charges
DFR II-D-19	Federal Corporate Graduated Income Tax Rates
DFR II-D-20	Cost of Removal
DFR II-D-21	Income Tax Gain/Loss Carryovers
DFR II-D-22	Elim of Tax Savings by Payment of Interest on CWIP
DFR II-D-23	Consol. Tax Return Election - §1552
DFR II-D-24	Deferred Taxes Related to Depreciation
DFR II-D-25	Deferred Investment Tax Credits

**Duquesne Light Company**  
**Calculation of Consolidated Tax Adjustment**  
**In Thousands (000)**

**EXHIBIT MLS-2**

	Taxable Income 2020	Taxable Income 2021	Taxable Income 2022	
<u>Tax Loss Companies</u>				
DQE HOLDINGS, LLC	(4,233)	(2,930)	(2,469)	
DUQUESNE LIGHT HOLDINGS, INC.	(60,835)	(37,417)	(30,381)	
TEN CONNECTED SOLUTIONS, INC.	-	(247)	(73)	
THE EFFICIENCY NETWORK, INC.	-	-	(261)	
Total Tax Loss	(65,068)	(40,594)	(33,184)	
<u>Tax Positive Companies</u>				
DUQUESNE LIGHT COMPANY	151,286	111,528	152,003	
TEN CONNECTED SOLUTIONS, INC.	1,193	-	-	
THE EFFICIENCY NETWORK, INC.	2,186	1,296	-	
DQE CAPITAL CORPORATION	-	-	-	
DQE ENTERPRISES, INC.	26	0	7	
DES CORPORATE SERVICES INC.	-	-	-	
Total Taxable Income	154,691	112,824	152,010	
Total Consolidated Income/(Loss)	89,623	72,230	118,826	
% of Total	97.80%	98.85%	100.00%	
Total Allocated Tax Loss	(63,636)	(40,127)	(33,183)	(45,649)
Distribution allocation				54.89% [a]
Loss allocated to Distribution				(25,057)
Federal Tax rate				21.0%
Consolidated Tax Adjustment				(5,262)

[a] Source: Mr. Gorman testimony, Statement #13, Jurisdictional Separation Study Exhibit 6-8A, JSS Factors - FedTax\_Pres Distribution percentage