

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION**

Witness: Linda C. Bridwell

- 1.** Provide Kentucky-American's income statement, balance sheet, and statement of retained earnings for the calendar year ending December 31, 2017.

Response:

Please refer to the attachment. The numbers presented on the attachment are jurisdictional financial results for KAW that have removed a one-time land sale with corresponding tax. This occurred in September 2017.

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Witness: **Linda C. Bridwell/Scott Rungren**

- 2.** Provide Kentucky-American's Net Investment Rate Base and Capital Structure for 2017. Provide all supporting work papers, assumptions, and calculations.

Response:

Please refer to Attachment 1 for Rate Base and Attachment 2 for the Capital Structure.

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Witness: **Linda C. Bridwell/Scott Rungren**

3. Using the financial information provided in the responses to Items 1 and 2, calculate:
- a. Kentucky-American's actual Return on Equity (income available to common shareholders divided by common equity) for the calendar year ending December 31, 2017.
 - b. Kentucky-American's average cost of long-term debt for the calendar year ending December 31, 2017.
 - c. Kentucky-American's average cost of short-term debt for the calendar year ending December 31, 2017.
 - d. Provide all supporting work papers, assumptions, and calculations.

Response:

- a. KAW's actual return on average common equity for the year ended December 31, 2017 was 8.884%, calculated as shown below:

Net Income Available to Common Shareholders	\$17,124,240	
Common Equity at 12/31/2016		\$186,819,140
Common Equity at 12/31/2017		\$198,689,748
Average Common Equity	\$192,754,444	
Return on Common Equity	8.884%	

Note: The numbers presented are for jurisdictional financial results for Kentucky American and have removed a one-time land sale that occurred in September of 2017, along with corresponding tax.

- b. KAW's average cost of long-term debt for the calendar year ending December 31, 2017 was 6.02%.
- c. KAW's average cost of short-term debt for the calendar year ending December 31, 2017 was 1.23%.
- d. Please see Attachment 1 for the supporting work paper for Parts b and c.

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Witness: Linda C. Bridwell/Scott Rungren

4. Using the Capital Structure provided in the response to Item 1 and the return/interest rates calculated in the response to Item 3, fill out the table below:

Component of Capitalization	Per Books 12/31/17	Ratios	Actual Rates	Average Weighted Cost
Short-Term Debt				
Long-Term Debt				
Preferred Stock				
Common Equity				
Total Capitalization	\$ -	0.000%		0.0000%

Response:

Component of Capitalization	Average Net Balance For The Year Ended 12/31/17	Ratio	Cost Rate	Average Weighted Cost
Short-Term Debt	\$17,133,359	4.140%	1.225%	0.050%
Long-Term Debt	201,723,063	48.743%	6.020%	2.930%
Preferred Stock	2,242,500	0.542%	8.520%	0.050%
Common Equity ¹	192,754,444	46.575%	8.907%	4.150%
Total Capitalization	\$413,853,365	100.000%		7.180%

- 1) The common equity balance and cost rate reflect the removal of the gain from the one-time land sale that occurred in September of 2017.

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Witness: John R. Wilde

5. Using the table below, provide the calculation of the gross revenue conversion factor ("GRCF") including a 35 percent Federal Income Tax ("FIX") rate.

Line #	Description	Rates	State	Federal
1	Operating Revenue		100.000000%	100.000000%
2	Less: Uncollectible Expense			
3	Less: PSC Assessment			
4	Less: Production Activities Deduction State			
5				
6	Income before State Income Tax		100.000000%	100.000000%
7	State Income Tax		0.000000%	0.000000%
8				
9	Income before Federal Income Tax			100.000000%
10	Federal Income Tax			0.000000%
11				
12	Operating Income Percentage (Line 9 - Line 10)			100.000000%
13				
14	Gross Revenue Conversion FACTOR (Line 1 / Line 12)			1.000000
15				
16	Composite Income Tax Rate (Line 7 + Line 10)			0.000000%
17				
18	Common Equity Gross-up (Line 16 / (1 - Line 16))			0.000000%

Response:

Please refer to the attachment.

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Witness: John R. Wilde

- 6.** Using the table below, provide the calculation of the GRCF including a 21 percent FIT rate.

Line #	Description	Rates	State	Federal
1	Operating Revenue		100.000000%	100.000000%
2	Less: Uncollectible Expense			
3	Less: PSC Assessment			
4	Less: Production Activities Deduction State			
5				
6	Income before State Income Tax		100.000000%	100.000000%
7	State Income Tax		0.000000%	0.000000%
8				
9	Income before Federal Income Tax			100.000000%
10	Federal Income Tax			0.000000%
11				
12	Operating Income Percentage (Line 9 - Line 10)			100.000000%
13				
14	Gross Revenue Conversion FACTOR (Line 1 / Line 12)			1.000000
15				
16	Composite Income Tax Rate (Line 7 + Line 10)			0.000000%
17				
18	Common Equity Gross-up (Line 16 / (1 - Line 16))			0.000000%

Response:

Please refer to the attachment.

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7. Using the table below, calculate the weighted average cost of capital (“WACC”) with a 35 percent FIT rate and WACC with a 21 percent FIT rate.

Component of Capitalization	Average Weighted Cost	Adjusted Weighted Cost of Capital to Reflect 35% Fed. Tax Rate		Adjusted Weighted Cost of Capital to Reflect 21% Fed. Tax Rate	
		Equity Gross-up	Adj. Cost	Equity Gross-up	Adj. Cost
Short-Term Debt			0.00%		0.00%
Long-Term Debt			0.00%		0.00%
Preferred Stock			0.00%		0.00%
Common Equity			0.00%		0.00%
Total Capitalization	<u>0.0000%</u>	<u>0.0000%</u>	<u>0.0000%</u>	<u>0.0000%</u>	<u>0.0000%</u>

Response:

Component of Capitalization	Average Weighted Cost	Adjusted Weighted Cost of Capital to Reflect 35% Fed. Tax Rate		Adjusted Weighted Cost of Capital to Reflect 21% Fed. Tax Rate	
		Equity Gross-Up	Adj. Cost	Equity Gross-Up	Adj. Cost
Short-Term Debt	0.050%	1.00	0.050%	1.00	0.050%
Long-Term Debt	2.930%	1.00	2.930%	1.00	2.930%
Preferred Stock	0.050%	1.00	0.050%	1.00	0.050%
Common Equity	4.150%	1.6527	6.859%	1.3598	5.643%
Total Capitalization	<u>7.180%</u>		<u>9.889%</u>		<u>8.673%</u>

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8. Refer to the Direct Testimony of John R. Wilde at 4. Given that Kentucky Utilities Company, Louisville Gas and Electric Company, and other utilities were able to calculate the impact the Tax Cuts and Jobs Act has on the excess accumulated deferred income taxes ("ADIT"), explain in detail why Kentucky-American is unable to calculate the impact to its excess ADIT.

Response:

In Mr. Wilde's January 26, 2018 testimony, he states on page 4 that "KAWC will estimate the impact of the re-measurement of ADIT balances in its 2017 financial statements to be finalized later in February, and will need to revise those estimates over the next year as more information becomes available and in preparing 2017 and resolving prior tax returns."

KAW, solely for financial reporting purposes under ASC 740, computed a re-measurement of its ADIT. This estimate was subject to the provisions contained in SEC Staff Accounting Bulletin 118. In SAB 118, SEC staff acknowledges that any amount booked is an estimate subject to change, and as such gives companies a one-year measurement period to make changes. The estimate provided here can and will change within the next year primarily driven mainly by the KAW's parent filing of its income tax returns.

Subject to guidance in SAP 118, KAW re-measured its ADIT. Substantially all of the amount of the re-measurement was recorded in a regulatory liability account reflecting KAW's belief the amounts will be refunded to customers through normalization of the amounts in the future. In the recently filed AWW 10K, KAW recorded a regulatory liability (exclusive of the gross-up) of approximately \$32.8 million dollars.

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9. Using Kentucky-American's responses to this Request for Information and the table below, provide the revenue reduction resulting from the decrease in the FIT rate from 35 percent to 21 percent.

Line No.	Description	35% Federal Income Tax Rate	21% Federal Income Tax Rate	Revenue Impact
1	Net Investment Rate Base			
2	Returns Adjusted For Income Taxes			
3				
4	Required Annual Operating Income Before Taxes (Line 1 x Line 2)	\$ -	\$ -	\$ -
5				
6	Amortization Of Excess ADIT (Protected) - Using Aram			
7	Amortization Of Excess ADIT (Unprotected)			
8				
9	Total Amortization Of Excess ADIT (Line 6 + Line 7)		-	
10	Gross-Up Factor Using 21% Federal Tax Rate			
11				
11	Total Reduction In Deferred Income Tax Expense (Line 9 x Line 10)			-
12				
13	Total Reduction In Revenue Requirements (Line 4 + Line 11)			\$ -

If Kentucky-American lacks sufficient information to apply the ARAM method, please instead use the Reverse South Georgia Method to calculate the amortization of excess protected ADIT in Line 6 of the above table. If estimates and assumptions were made to calculate the amounts identified in response to this Request, please identify and describe any estimates and assumptions.

Response:

KAW is not completing the requested template computing a reduction in revenue requirements, because the Company believes it would be imprudent to do so because of the possibility of violating tax normalization rules.

KAW currently lacks the information to develop an estimate for the excess ADIT that could be provided for in the revenue requirements formula. In addition, while the question may contemplate that the necessary offsets in revenue requirements would be addressed pursuant to setting rates, the requested calculation does not provide for the offsetting adjustments to rate base and its effects on revenue requirements that would be required in the context of addressing excess ADIT amounts pursuant to consistency provisions of the tax normalization rules.

KAW, to satisfy the financial accounting rules, has developed a reasonable¹ estimate of the Excess ADIT balances and the offsetting regulatory liability to be booked in accordance with the relevant financial accounting rules so it could produce financial statements as of 12/31/2017. Subsequently, for purposes of discussion, KAW has split that estimate between excess that is related to plant, and not related to plant (non-plant). The reasonable estimated computed and subject to revision is \$30,163,661 for plant, and \$2,618,551 for non-plant.

Also, for discussion purposes, KAW has developed a reasonable estimate to simulate a amortization period for plant related excess pursuant to RSGM on a total KAW basis. KAW has not made a determination if it will be required to use ARAM, or if it can or should be using RSGM to address the effects of the TCJA. It is unclear at this time to KAW if it can use RSGM, and if it would need to develop estimates specific to water and wastewater plant separately, and further, it would need to develop estimates specific to each wastewater rate jurisdiction.

Companies that have been using ARAM as a method to address prior changes in law are better positioned to split out its estimates between protected and unprotected balances. Companies like KAW that have used RSGM as a method to address prior changes in law do not have a ready method to split its estimates between protected and unprotected excess balances. If a company can isolate its protected Excess ADIT from unprotected Excess ADIT, it likely is required to use ARAM.

Companies that are using ARAM, and are not subject to a consent decree with the IRS to use a normalized method of accounting for tax repairs, will likely have an unprotected plant Excess ADIT balance that might be available to be drawn upon in a rate setting process to avoid a normalization violation if the ARAM calculation used to set rates did not align to a more complete estimate analyzed subsequent to rates being set. KAW changed its method of accounting for repairs subsequent to a consent decree requiring KAW to use a normalized method of accounting for tax repairs.² Therefore, KAW's unprotected excess balance is likely an asset or receivable from customers, and not a liability to customers. Thus, greater precision is likely needed for KAW to address its estimate for Excess ADIT in setting rates. It is our estimate that KAW will be able to do this in the first or second quarter of 2019.

¹ Securities and Exchange Commission Staff Accounting Bulletin 118.

² See the attached 2008 Consent Decree from the IRS requiring the use of a normalized method of accounting to allow KAW to claim tax repairs for plant capitalized for financial accounting purposes.

TCJA as enacted requires the use of ARAM, with an exception that would allow a utility to use RSGM.³ How to apply the exception with certainty is not yet known. Even though KAW met the exception to use RSGM related to the excess of prior changes in law, each law change requiring an analysis of tax normalization rules must be analyzed and interpreted separately based on the facts and circumstances relevant on and after the date of the law's enactment. While KAW does not have the records in a format and in a system suitable for ARAM, it has the records and systems needed to do ARAM. KAW requires more time to execute such an effort. If KAW uses ARAM it will in effect be using a safe harbor method, and will be using a method that is much more robust in dealing with future changes in tax law. If KAW uses RSGM before it has fully analyzed its ability to do so, it runs the risk that its RSGM estimate will provide a greater amount of Excess ADIT to customers than would be allowed pursuant to ARAM, and would be in violation of the tax normalization rules. The penalties that would accrue to KAW if ordered to do so are two-fold, as outlined in the TCJA.⁴

The delay KAW seeks before beginning to address TCJA related excess ADIT balances in customer rates will provide customers and shareholders the benefit of being highly certain on tax positions related to applying the tax normalization rules. The delay is temporary and there can be a very short catchup period to amortize the amounts deferred during the delay. The time value of the delay is captured in the lower rate base and resulting lower revenue requirement that will occur over the period of delay.

³ TCJA Section 1561(d)(1).

⁴ TCJA Section 1561(d)(4).



AMERICAN WATER

September 10, 2010

Courier's Desk
Internal Revenue Service
Attn: CC:ITA:B01- Innessa Glazman
1111 Constitution Avenue, N.W., Room 5336
Washington, DC 20224

RE: American Water Works Company, Inc. & Subs.
EIN: 51-0063696
CAM-108421-09
CONSENT AGREEMENT

RECEIVED
INTERNAL REVENUE SERVICE
2010 SEP 13 PM 12:31

Dear Ms. Glazman:

This letter relates to a Form 3115, Application for Change in Accounting Method, filed by the above-mentioned Taxpayer on behalf of itself and various subsidiaries, requesting permission to change their method of accounting for (1) costs to repair and maintain tangible property, and (2) dispositions of certain tangible depreciable property, for the taxable year that ended December 31, 2008.

Please find enclosed a Consent Agreement dated July 30, 2010, and signed by the Taxpayer on September 10, 2010. However, we note that the EINs for two of the entities subject to the Form 3115 and enclosed Consent Agreement, American Water Engineering, Inc., and United Water Virginia, Inc., were incorrectly reflected in Appendix A to the Consent Agreement. In its information response to the IRS, by letter dated July 1, 2009, the Taxpayer provided the correct EINs of the two entities, American Water Engineering, Inc. (EIN: 76-0654501), and United Water Virginia, Inc. (EIN: 54-1016694). The Taxpayer will be effecting the change permitted in the Consent Agreement.

If you have any questions, please call the Taxpayer's authorized representative, Robert Weiss, at 202-414-1421.

Sincerely,

Mark Chesla
Vice President and Controller

Enclosures
Executed Consent Agreement

RECEIVED
INTERNAL REVENUE SERVICE
2010 SEP 13 PM

CONSENT AGREEMENT

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

American Water Works Company, Inc.
and Subs.
P.O. Box 5600
Cherry Hill, NJ 08003

Attn: Mark N. Chesla
VP and Controller

EIN: 51-0063696

Person to Contact:

Innessa Glazman

Telephone Number:

(202) 622-7327

Refer Reply to:

CC:ITA:B01 CAM-108421-09

Employee Identification Number:

52-08393

JUL 30 2010

In re: Application for Change of Accounting Method
Form 3115 - See Appendix A

Dear Mr. Chesla:

This letter refers to a Form 3115, Application for Change in Accounting Method, filed by American Water Works Company, Inc. & Subs., EIN:51-0063696, on behalf of thirty applicants (see Appendix A) (collectively "the taxpayer"), requesting permission to change the taxpayer's method of accounting for: (1) costs to repair and maintain tangible property, and (2) dispositions of certain tangible depreciable property. The change is requested for the taxable period beginning January 1, 2008 and ending December 31, 2008 ("year of change").

The Department of the Treasury has published proposed regulations that clarify the application of §§ 162 and 263 of the Internal Revenue Code to expenditures paid or incurred to repair, improve, or rehabilitate tangible property. See Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property, 73 FR 12838-01 (March 10, 2008), 2008-1 C.B. 871. A threshold issue in applying the rules under §§ 162 and 263 is determining the appropriate unit of property to which the rules should be applied. The proposed regulations reserve the rules for determining the appropriate unit of property for network assets, which are defined as railroad track, oil and gas pipelines, water and sewage pipelines, power transmission and distribution lines, and telephone and cable lines. See § 1.263(a)-3(d)(2)(iii)(C)(2) of the proposed regulations, 73 FR 12857. The preamble to the proposed regulations states that the unit of property for network assets should be addressed on an industry-by-industry basis in future Internal Revenue Bulletin guidance. See preamble discussion at 73 FR 12843.

Section 6.09 of Rev. Proc. 2010-1, 2010-1 I.R.B. 1, 16, provides that the Internal Revenue Service generally will not issue a letter ruling if the request presents an issue that cannot be readily resolved before a regulation or any other published guidance is issued. A letter ruling includes an Associate Office's response granting or denying a

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CAM-108421-09

request for a change in a taxpayer's accounting method. Section 2.01 of Rev. Proc. 2010-1. The unit of property determination for network assets is an issue that cannot be readily resolved before a regulation or other published guidance is issued. Further, because the taxpayer's proposed method of accounting is based on the unit of property determination, the propriety of the taxpayer's proposed method of accounting is also an issue that cannot be readily resolved. Thus, the Service declines to rule on whether the taxpayer's unit of property determination for its network asset is correct, and accordingly, whether its proposed method of accounting is a proper method of accounting.

Further, pursuant to section 4.02(1) of Rev. Proc. 2010-3, 2010-1 I.R.B. 110, 118, the Service will not ordinarily issue a letter ruling or determination letter on any matter in which the determination requested is primarily one of fact. The determination of the unit of property for dispositions of tangible depreciable property is a factual one. Thus, the Service declines to rule on whether the taxpayer is using the appropriate unit of property for determining dispositions of tangible depreciable property subject to its Form 3115 and, accordingly, whether its proposed method of accounting for determining dispositions of such property is a proper method of accounting.

FACTS

The taxpayer is a corporation that is in the business of operating as public water and wastewater utility company that pumps, treats, and distributes water to and from residential, commercial, and industrial customers in the United States. The taxpayer uses an overall accrual method of accounting. Its principal business activity code is 221300. The taxpayer is requesting permission to: (1) change its method of accounting for costs associated with the routine repair and maintenance of all of the taxpayer's network assets; and (2) change its units of property for determining dispositions of certain tangible depreciable property.

Routine repair and maintenance costs

The costs included in this request consist of costs associated with the routine repair and maintenance of taxpayer's tangible property. The taxpayer represents that these costs are incurred to keep the taxpayer's property in ordinarily efficient operating condition, and that they do not materially increase the value or substantially prolong the useful life of any unit of property compared to the value or useful life of the property before the general decline or event that led to the repairs or maintenance. The taxpayer represents that the repair and maintenance costs do not adapt any unit of property to a new or different use. The taxpayer represents that the repair and maintenance costs do not include costs to replace any unit of property or any major components or substantial

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structural parts of any unit of property. The taxpayer represents that the repair and maintenance costs are not incurred as part of a plan of rehabilitation, modernization, or improvement to any unit of property. The taxpayer represents that the repair and maintenance costs do not result from any prior owner's use of any unit of property.

Section 162 allows a deduction for all the ordinary and necessary expenses paid during the taxable year in carrying on any trade or business.

Section 1.162-4 of the Income Tax Regulations allows a deduction for the cost of incidental repairs that neither materially add to the value of property nor appreciably prolong its useful life, but keep it in an ordinarily efficient operating condition.

Under the taxpayer's present method of accounting for repair and maintenance costs, the taxpayer capitalizes the repair and maintenance costs described above and recovers these costs using the appropriate method over the applicable recovery period and the applicable convention as prescribed by §168(a).

Under the taxpayer's proposed method of accounting for repair and maintenance costs, the taxpayer will treat the repair and maintenance costs as ordinary and necessary business expenses pursuant to §§ 162 and 1.162-4.

Disposition of certain tangible depreciable property

The items of tangible depreciable property subject to the taxpayer's request to change its units of property for determining dispositions are described as network assets. Such property is depreciated by the taxpayer under § 168.

The taxpayer represents that:

1. None of the assets that are the subject of the taxpayer's Form 3115 are leasehold improvements.
2. None of the assets subject to the taxpayer's Form 3115 is subject to a general asset account election under § 168(i)(4) and the regulations thereunder.
3. None of the assets subject to the taxpayer's Form 3115 is subject to a mass asset account election under former § 168(d)(2)(A).
4. Depreciation for all of the assets subject to the taxpayer's Form 3115 is not determined in accordance with § 1.167(a)-11 (regarding the Class Life Asset Depreciation Range System (ADR)).

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5. None of the assets subject to the taxpayer's Form 3115 is subject to the repair allowance under § 1.167(a)-11(d)(2) (including expenditures incurred after December 31, 1980, that were for the repair, maintenance, rehabilitation, or improvement of property placed in service by the taxpayer before January 1, 1981).

6. None of the assets subject to the taxpayer's Form 3115 were disposed of in a transaction to which a nonrecognition section of the Code applies (for example, § 1031, transactions subject to § 168(i)(7)).

7. There is no building (and its structural components) that is the subject of the taxpayer's Form 3115.

Under the taxpayer's present method of accounting, the taxpayer uses a method other than the functional interdependence test to identify the unit of property for purposes of determining when a depreciable network asset is disposed of.

Under the taxpayer's proposed method of accounting, the taxpayer will use the functional interdependence test to identify the unit of property for purposes of determining when a depreciable network asset is disposed of. The taxpayer will use the same unit of property for purposes of determining when a depreciable network asset is placed in service (and when depreciation begins) and when the depreciable network asset is disposed of (and when depreciation ends).

The taxpayer has represented that, on the date the Form 3115 was filed, it was not under examination and it was not before an appeals office or a federal court with respect to any income tax issue. See sections 3.07, 3.08(2) and 3.08(3) of Rev. Proc. 97-27, 1997-1 C.B. 680, as modified by Rev. Proc. 2002-19, 2002-1 C.B. 696.

SECTION 481(a) ADJUSTMENT

The information provided indicates that, as of the beginning of the year of change, the required aggregate adjustment under § 481(a) (the § 481(a) adjustment) for the year of change is (\$461,238,422). This amount represents a netting of the net negative § 481(a) adjustment for maintenance and repairs with the net positive § 481(a) adjustment for dispositions. The netting represents a one-time exception allowed the taxpayer for the year of change based on its particular situation. As a rule, the netting of the § 481(a) adjustment for maintenance and repairs with the § 481(a) adjustment for dispositions is not allowed under the provisions of Rev. Proc. 97-27. The § 481(a) adjustment for each applicant is shown in Appendix A. The net amount represents a decrease in computing taxable income.

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CONSENT/TERMS AND CONDITIONS OF CONSENT

Based solely on the facts presented and representations made, permission is hereby granted the taxpayer to change its method of accounting from the present method to the proposed method, beginning with the year of change, provided that:

- (1) The taxpayer takes the entire net § 481(a) adjustment into account in computing taxable income in the year of change. See section 2.02(1) of Rev. Proc. 2002-19, 2002-1 C.B. 696, as amplified and clarified by Rev. Proc. 2002-54, 2002-2 C.B. 432.
- (2) The taxpayer keeps its books and records for the year of change and for subsequent taxable years (provided they are not closed on the date it receives this letter) on the method of accounting granted in this letter. This condition is considered satisfied if the taxpayer reconciles the results obtained under the method used in keeping its books and records and the method used for federal income tax purposes and maintains sufficient records to support such reconciliation; and
- (3) No portion of any net operating loss that is attributable to a negative § 481(a) adjustment may be carried back to a taxable year prior to the year of change that is the subject of any pending or future criminal investigation or proceeding concerning (a) directly or indirectly, any issue relating to the taxpayer's federal tax liability, or (b) the possibility of false or fraudulent statements made by the taxpayer with respect to any issue relating to its federal tax liability. See section 5.02(4) of Rev. Proc. 97-27.
- (4) None of the items of property subject to the taxpayer's Form 3115 is subject to a general asset account election under § 168(i)(4) and the regulations thereunder;
- (5) None of the items of property subject to the taxpayer's Form 3115 is subject to a mass asset account election under former § 168(d)(2)(A);
- (6) The taxpayer does not determine depreciation for any of the items of property subject to the taxpayer's Form 3115 in accordance with § 1.167(a)-11 (regarding the Class Life Asset Depreciation Range System (ADR));

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- (7) None of the items of property subject to the taxpayer's Form 3115 is subject to the repair allowance under § 1.167(a)-11(d)(2) (including expenditures incurred after December 31, 1980, for the repair, maintenance, rehabilitation, or improvement of property placed in service before January 1, 1981);
- (8) None of the cost (or a portion thereof) of the assets subject to the taxpayer's Form 3115 is expensed or amortized under any provision of the Code, regulations, or other published guidance in the Internal Revenue Bulletin (for example, § 179D, § 1400I); and,
- 9) **If any item of property subject to the taxpayer's Form 3115 is public utility property within the meaning of § 168(i)(10) or former § 167(l)(3)(A):**
- (A) A normalization method of accounting (within the meaning of § 168(i)(9), former § 168(e)(3)(B), or former § 167(l)(3)(G), as applicable) must be used for such public utility property;**
- B) As of the beginning of the year of change, the taxpayer must adjust its deferred tax reserve account or similar reserve account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to such public utility property; and
- C) Within 30 calendar days of filing the federal income tax return for the year of change or of receiving this letter ruling, whichever is later, the taxpayer must provide a copy of its Form 3115 (and any additional information submitted to the Service in connection with such Form 3115) to any regulatory body having jurisdiction over such public utility property.

EFFECT OF THIS ACCOUNTING METHOD CHANGE

The accounting method change granted in this letter is a letter ruling pursuant to § 601.204(c) of the Statement of Procedural Rules. See also section 2.01 of Rev. Proc. 2010-1, 2010-1 I.R.B. at 6 (or any successor). The taxpayer ordinarily may rely on this letter ruling subject to the conditions and limitations described in Rev. Proc. 97-27.

However, the consent granted under this letter ruling for the taxpayer's requested change is not a determination by the Commissioner that the taxpayer is using the appropriate unit of property for determining dispositions of tangible depreciable property and does not create any presumption that the proposed unit of property is permissible

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for such purposes. The director will ascertain whether the taxpayer's determination of its unit of property for dispositions of tangible depreciable property is correct.

Further, the taxpayer should not infer approval of any tax treatment not specifically stated in this letter ruling. For example, this letter does not address the application of § 263A, which generally requires taxpayers to capitalize certain direct and indirect costs of property produced or acquired for resale, or the propriety of the taxpayer's classification of property under § 168(e) or Rev. Proc. 87-56, 1987-2 C.B. 678. Further, this letter ruling does not imply approval of any tax treatment (including amounts that are part of the § 481(a) adjustment) when the Code, the regulations, or other published guidance provides specific limitations and/or prohibitions. The Service expresses no opinion on the propriety of the unit(s) of property the taxpayer proposes to use in determining the deductibility of repair and maintenance costs. The unit of property determination is a factual one within the jurisdiction of the director.

The director must apply the ruling in determining the taxpayer's liability unless the director recommends that the ruling should be modified or revoked. The director will ascertain whether (1) the representations upon which this ruling was based reflect an accurate statement of the material facts, (2) the change in method of accounting was implemented as proposed in accordance with the terms and conditions of the Consent Agreement and Rev. Proc. 97-27, (3) there has been any change in the material facts upon which the ruling was based during the period the method of accounting was used, (4) there has been any change in the applicable law during the period the method of accounting was used, (5) the amount of the § 481(a) adjustment was properly determined, and (6) the taxpayer's determination of its unit of property is correct. In the case of (1), (2), (3), or (4) above, if the director recommends that the ruling should be modified or revoked, the director will forward the matter to the national office for consideration before any further action is taken. Such a referral to the national office will be treated as a request for technical advice, and the provisions of Rev. Proc. 2010-2, 2010-1 I.R.B. 90 (or any successor) will be followed. See section 11.01 of Rev. Proc. 97-27.

As noted above, the Department of the Treasury has published proposed regulations that clarify the application of §§ 162 and 263 to expenditures paid or incurred to repair, improve, or rehabilitate tangible property. See Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property, 73 FR 12838-01 (March 10, 2008), 2008-1 C.B. 871. If final or temporary regulations are adopted with positions that are inconsistent with the method of accounting that the taxpayer implements in accordance with this letter ruling, the taxpayer will be required to follow any instructions in those final or temporary regulations concerning methods of accounting for the repair, improvement, or rehabilitation of tangible property for future taxable years.

American Water Works Company, Inc. & Subsidiaries
CAM-108421-09

AUDIT PROTECTION

An examining agent may not propose that the taxpayer change the same method of accounting as the method changed by the taxpayer under this ruling for a year prior to the year of change provided the taxpayer implements the change as proposed, in accordance with the terms and conditions of this ruling and Rev. Proc. 97-27, and the ruling is not modified or revoked retroactively because there has been a misstatement or an omission of material facts. See sections 9.01 and 9.02(1) of Rev. Proc. 97-27.

However, the Service may change the taxpayer's method of accounting for the same item for taxable years prior to the requested year of change if there is any pending or future criminal investigation or proceeding concerning (a) directly or indirectly, any issue relating to the taxpayer's federal tax liability for any taxable year prior to the year of change, or (b) the possibility of false or fraudulent statements made by the taxpayer with respect to any issue relating to its federal tax liability for any taxable year prior to the year of change. See section 9.02(4) of Rev. Proc. 97-27.

CONSENT AGREEMENT

If the taxpayer agrees to the terms and conditions set forth above, an individual with the authority to bind the taxpayer in such matters must sign and date the attached copy and return it within 45 days from the date of this letter to:

Internal Revenue Service
Attention: Innessa Glazman, CC:ITA:B01
P.O. Box 14095
Benjamin Franklin Station
Washington, D.C. 20044

The signed copy constitutes an agreement regarding the terms and conditions under which the change is to be effected ("Consent Agreement") within the meaning of § 481(c) and as required by § 1.481-4(b). The Consent Agreement shall be binding on both parties except that it will not be binding upon a showing of fraud, malfeasance, or misrepresentation of a material fact. In addition, a copy of the executed Consent Agreement must be attached to the taxpayer's federal income tax return for the year of change. For further instructions, see section 8.11 of Rev. Proc. 97-27. Alternatively, a taxpayer that files its returns electronically may satisfy this requirement by attaching a statement to its return that provides the date and control number of this letter ruling.

American Water Works Company, Inc. & Subsidiaries
CAM-108421-09

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

The accounting method change granted in this letter is directed only to the taxpayer and may not be used or cited as precedent. See section 11.02 of Rev. Proc. 2010-1, 2010-1 I.R.B. at 49. Final or temporary regulations under § 167 or § 168 pertaining to one or more of the issues addressed in this letter ruling have not yet been adopted. Therefore, if final or temporary regulations under § 167 or § 168 should be adopted with positions that are inconsistent with the conclusions reached in this letter ruling, the method of accounting utilized as a result of the letter ruling will no longer be regarded as a proper method of accounting and would be subject to change within the framework of §§ 446 and 481.

American Water Works Company, Inc. & Subsidiaries
CAM-108421-09

In accordance with the provisions of a power of attorney currently on file, we are sending a copy of the ruling letter to your authorized representatives.

Sincerely yours,



JOHN P. MORIARTY
Chief, Branch 1
Office of the Associate Chief Counsel
(Income Tax and Accounting)

cc: Internal Revenue Service
Industry Director, LM:NRC
Natural Resources and Construction
1919 Smith Street, Stop 1000HOU
Houston, TX 77083

Robert Weiss
PricewaterhouseCoopers LLP
1301 K Street, NW, Ste 800W
Washington, DC 20005

Gwynneth H. Stott, CPA
PricewaterhouseCoopers LLP
2001 Market Street, Ste 1700
Philadelphia, PA 19103

Signed this 10th day
of SEPTEMBER, 20~~09~~¹⁰

AMERICAN WATER WORKS INC & SUBS
(taxpayer)

By Allen, VICE PRESIDENT AND CONTROLLER
(Name and corporate title of parent officer)

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION

Witness: John R. Wilde

- 10.** Using Kentucky-American's responses to this Request for Information and the table below provide the revenue reduction resulting from the decrease in the FIT rate from 35 percent to 21 percent.

Line No.	Description	35% Federal Income Tax Rate	21% Federal Income Tax Rate	Revenue Impact
1	Capitalization			
2	Returns Adjusted For Income Taxes			
3				
4	Required Annual Operating Income Before Taxes (Line 1 x Line 2)	\$ -	\$ -	\$ -
5				
6	Amortization Of Excess ADIT (Protected) - Using Aram			
7	Amortization Of Excess ADIT (Unprotected)			
8				
9	Total Amortization Of Excess ADIT (Line 6 + Line 7)		-	
10	Gross-Up Factor Using 21% Federal Tax Rate			
11				
11	Total Reduction In Deferred Income Tax Expense (Line 9 x Line 10)			-
12				
13	Total Reduction In Revenue Requirements (Line 4 + Line 11)			\$ -

Response:

Please refer to the response to Item 9.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION

Witness: **John R. Wilde**

- 11.** Provide an updated schedule to reflect the actual revenues recorded in 2017 by customer class.

Response:

 Please refer to the attachment.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION

Witness: **John R. Wilde**

- 12.** Explain whether any of the expenses charged to Kentucky American by its affiliates in the test year contain any FIT implications. If so, state whether Kentucky-American addressed the impacts on its revenue requirements. If not, provide the impact of the FIT implications on Kentucky-American's test-year expense and revenue requirement.

Response:

There are no service company billings in the last rate case that would change as a result of the change in tax rates as service company bills out all of its pre-tax costs and does not earn a return requiring a gross-up.

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION**

Witness: John R. Wilde

- 13.** State whether Kentucky-American has received any letter or written opinion from the Internal Revenue Service since January 1, 2010 regarding the treatment of Kentucky-American's excess ADIT and, if so, provide a copy of the letter or written opinion.

Response:

Kentucky American has not received any written opinion from the Internal Revenue Service since January 1, 2010 regarding the treatment of Kentucky-American's excess ADIT.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION

Witness: **John R. Wilde**

- 14.** Provide any letters or written opinions prepared by the Internal Revenue Service and relied on by Kentucky-American or its agents to calculate Kentucky-American's excess ADIT or to determine how the excess ADIT may be reimbursed to ratepayers under federal tax law, regardless of whether those letters or written opinions were prepared for or at the request of Kentucky-American.

Response:

Only twice did federal income tax law address specifically the return of excess deferred income taxes. Most recently, as the Commission is aware, the Tax Cuts and Jobs Act ("TCJA") in section 13001 provides for the normalization of excess deferred taxes created specifically by the Act. Previously in the 1986 Tax Reform Act ("TRA"), section 203(e) addressed excess deferred taxes created by that act.

Regarding the TRA, IRS Revenue Procedure 88-12 was issued. It provided usage of Reverse South Georgia Method ("RSGM") in limited specific instances. Please refer to the attachment. We believe Kentucky-American relied on it to use RSGM. It should be noted that Revenue Procedure 88-12 is specific to excesses deferred taxes created by the Tax Reform Act of 1986, and looks to records that existed in 1987. It cannot be relied upon and is totally inapplicable to excesses created by the TCJA.

Regarding TCJA, there are no opinions of the IRS that exist to rely upon at this time.

Revenue Procedures, Revenue Procedure 88-12,, IRS News Release IR-IRB1988-8, Internal Revenue Service, (Jan. 28, 1988)

Revenue Procedure 88-12, 1988-1 CB 637, January 28, 1988.

[Code Sec. 168]

Accelerated cost recovery system: Public utilities: Excess tax reserves.—

The Internal Revenue Service provides a method for reducing the “excess tax reserve” for certain public utilities. The method satisfies the requirements of section 203(e) of the Tax Reform Act of 1986 if used by taxpayers that are unable to utilize the average rate assumption method because they have been required by a regulatory agency to compute depreciation on public utility property on the basis of an average life or composite rate method, as opposed to a method involving the use of vintage accounts. BACK REFERENCE: 88FED ¶1800.043.

SECTION 1. PURPOSE

This revenue procedure provides a method for reducing the “excess tax reserve” for certain public utility taxpayers. In general, the method satisfies the requirements of section 203(e) of the Tax Reform Act of 1986 (the Act), 1986-3 (Vol. 1) C.B. 63, if used by taxpayers that are unable to utilize the average rate assumption method because they have been required by a regulatory agency to compute depreciation on public utility property on the basis of an average life or composite rate method, as opposed to a method involving the use of vintage accounts.

SEC. 2. BACKGROUND

.01 Under a normalization method of accounting, the amount of tax expense that a taxpayer reports for ratemaking purposes includes a deferred tax amount to reflect the fact that the taxpayer is using an accelerated method of depreciation for federal income tax purposes. For taxable years beginning on or after July 1, 1987, section 601 of the Act, 1986-3 (Vol. 1) C.B. 166, reduces from 46 percent to 34 percent the maximum federal income tax applicable to corporations. Section 203(e) of the Act provides rules for reducing the excess tax reserve resulting both from that reduction and from the smaller reduction in rates for tax years starting before and ending after (straddling) July 1, 1987.

.02 Section 203(e) of the Act 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, if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces its excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method. Section 203(e)(2)(A) of the Act defines the term “excess tax reserve” as the excess of (i) the reserve for deferred taxes, described in section 167(1)(3)(G)(ii) of the Code (or former section 168(e)(3)(B)(ii) as in effect on the day before the enactment of the Act), over (ii) the amount that would be the balance in the reserve if the amount of the reserve were determined by assuming that the corporate tax rates provided by the Act were in effect for all prior periods. Section 203(e) also applies with respect to the excess tax reserve that occurs from the normalization requirement that taxpayers provide for deferred taxes at a rate in excess of 34 percent for any tax year (for example, a calendar year) that straddles July 1, 1987.

.03 The legislative history of the Act, however, indicates that section 203(e) of the Act does not apply to any amount of excess tax reserve generated from reductions in corporate tax rates that occurred before the enactment of the Act. For example, section 203(e) does not apply to any excess tax reserve resulting from the reduction in the maximum corporate tax rate from 48 percent to 46 percent under the Revenue Act of 1978, section 301, 1978-3 (Vol. 1) C.B. 54. See S. Rep. No. 313, 99th Cong., 2d Sess. 98 (1986), 1986-3 (Vol. 3) C.B. 98 (Senate Report); H.R. Rep. No. 426, 99th Cong., 1st Sess. 149 (1985), 1986-3 (Vol. 2) C.B. 149 (House Report). The provisions of prior law apply to the treatment of any excess tax reserve occurring from such previous rate reductions. Of course, a taxpayer may use the average rate assumption method with respect

to any excess tax reserve, including a reserve to which section 203(e) does not apply, without violating the normalization rules.

Moreover, the provisions of section 203(e) of the Act apply only with respect to the excess tax reserve resulting from depreciation occurring in years beginning before July 1, 1987, with respect to assets placed in service before January 1, 1987. See Senate Report at 98; see also House Report at 149.

Finally, the provisions of section 203(e) apply only with respect to the excess tax reserve resulting from depreciation "timing" differences that were required to be normalized under section 167 or 168 of the Code. Thus, for example, section 203(e) of the Act does not apply to the excess tax reserve resulting from the normalization of other book/tax timing differences, as described in section 1.167(1)-1(a)(1) of the Income Tax Regulations (for example, state income taxes). Cf. Rev. Rul. 87-139, 1987-52 I.R.B. 13, 14, which concludes that section 203(e) applies to the "voluntary" normalization method adopted by a taxpayer as described in that ruling.

.04 Section 203(e)(2)(B) of the Act defines the average rate assumption method as the method under which the excess tax reserve is reduced over the remaining lives of the property (as used in a public utility's regulated books of account) that gave rise to the reserve for deferred taxes. Under this method, the amount of the annual adjustment to the reserve for deferred taxes is the product of (i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property (the applicable average rate), and (ii) the amount of the timing differences that reverse during the year. The calculation is made as of the beginning of the year in which timing differences in the vintage account begin to reverse, that is, the first year in which the tax depreciation taken with respect to the vintage account is less than the amount of depreciation reflected in the regulated books of account computed on the tax basis. Thus, under the average rate assumption method, excess tax reserves pertaining to a particular vintage or vintage account are not flowed-through to ratepayers until such time as the timing differences in the particular vintage account reverse. Moreover, it is a violation of section 203(e) of the Act for taxpayers to adopt any accounting treatment that, directly or indirectly, circumvents the rule set forth in the previous sentence.

In addition, section 203(e) of the Act does not modify the normalization requirements of section 167(1) or section 168(j) of the Code. For example, a violation of the normalization rules occurs if a taxpayer provides for deferred taxes with respect to a particular vintage account at a tax rate less than the statutory rate applicable to the taxpayer for the current year in question.

.05 Some taxpayers have been required by regulatory agencies to depreciate property for regulatory purposes using a weighted average life or composite rate. A method of depreciation that uses a weighted average life or composite rate focuses on the entire plant and does not account for property by vintage accounts. Consequently, taxpayers that use this method may not have adequate data to apply the average rate assumption method.

SEC. 3 SCOPE

A taxpayer is described in this section 3 if, as of the first day of the taxable year that includes July 1, 1987, (i) the taxpayer was required by a regulatory agency to compute depreciation for public utility property on the basis of an average life or composite rate method, and (ii) the taxpayer's books and underlying records did not contain the vintage account data necessary to apply the average rate assumption method. If a taxpayer is subject to the jurisdiction of more than one regulatory body, the determination of the adequacy of the vintage accounting records for each asset or group of assets shall be determined on a jurisdiction-by-jurisdiction basis.

SEC. 4. DEFINITION OF REVERSE SOUTH GEORGIA METHOD

.01 In general, a taxpayer uses a method described in this section 4 if it (a) computes the excess tax reserve on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation for regulatory purposes, and (b) reduces the excess tax reserve ratably over the remaining regulatory life of the property. This method is sometimes referred to as the "Reverse South Georgia Method."

.02 *Special rule if a taxable year straddles July 1, 1987.* A taxpayer uses the method described in section 4 if the excess tax reserve is computed as of the first day of the year by subtracting from the reserve for deferred taxes (described in section 167(1) or 168(i)(9) of the Code) the amount that would be the balance of such reserve if the amount were determined by assuming that the weighted average tax rate for the year were in effect for all prior periods. (However, any reserve amount to which section 203(e) of the Act does not apply, as discussed in section 2.03 of this revenue procedure, is not required to be included in the excess tax reserve that is subject to ratable reduction under the Reverse South Georgia Method. Instead, the requirements of prior law apply to any such reserve amount). For a taxable year that straddles July 1, 1987, any reasonable method of calculating the weighted average tax rate shall be allowed under section 203(e). For example, under one acceptable method, the weighted average tax rate may be computed by using the marginal tax rate (46 percent) for the portion of the taxable year prior to July 1, 1987, and the marginal tax rate (34 percent) for the portion of the taxable year after July 1, 1987, weighted by the number of days in each period.

If the taxpayer has a taxable year that straddles July 1, 1987, then the taxpayer uses the method described by this section 4 for its succeeding taxable year if the excess tax reserve as of the first day of the succeeding taxable year is redetermined by subtracting from the reserve for deferred taxes (described in section 167(1) or 168(i)(9) of the Code) the amount that would be the balance of such reserve if the amount were determined by assuming that a 34 percent tax rate had been in effect for all prior periods. Redeterminations of the excess tax reserve are not made for subsequent years. Adjustments to the unamortized excess tax reserve may only be made to reflect asset retirements.

SEC. 5. APPLICATION

.01 If a taxpayer that is described in section 3 of this revenue procedure with respect to a jurisdiction uses the Reverse South Georgia Method described in section 4 for public utility property that is subject to the regulatory authority of that jurisdiction, then with respect to that property for that taxable year the taxpayer is deemed to satisfy the normalization requirements of section 203(e) of the Act.

.02 The use of the method described in section 4 by a taxpayer whose books and underlying records contain vintage year data for public utility property constitutes a violation of the requirements contained in section 203(e) of the Act if that method reduces the excess tax reserve more rapidly than the reserve would be reduced under the average rate assumption method.

SEC. 6. EFFECTIVE DATE

This revenue procedure is effective for any taxable year subject to section 203(e) of the Act.

DRAFTING INFORMATION

The principal author of this revenue procedure is Michael J. Hahn of the Corporation Tax Division. For further information regarding this revenue procedure, contact Noel J. Sheehan on (202) 566-3928 (not a toll-free call).

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION**

Witness: **Linda C. Bridwell**

- 15.** Provide Kentucky-American's fiscal year if different from the calendar year ending on December 31, 2017, and identify and describe any effect that a non-calendar fiscal year has on the calculation of excess ADIT.

Response:

Kentucky American's fiscal year is the calendar year ending on December 31, 2017.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION

Witness: **John R. Wilde**

- 16.** Provide the maximum total amount of excess protected ADIT that Kentucky-American contends may be reimbursed to ratepayers annually in 2018 and for each year thereafter through 2033 using the ARAM method. If Kentucky-American is not able to apply the ARAM method because it lacks the relevant information, please separately provide the maximum total amount of excess protected ADIT that Kentucky-American contends may be reimbursed to ratepayers annually in 2018 and for each year thereafter through 2033 using the Reverse South Georgia Method.

Response:

At this time, KAW is unable to provide the requested number under ARAM. That said, Kentucky-American is also not able to determine with any certainty that it qualifies for usage of Reverse South Georgia Method ("RSGM") given its facts and circumstances. To provide a number under RSGM when Kentucky-American is not confident it qualifies to use that number is risky because that number could be higher than the amount using ARAM, and either as a result of a change in the estimate of excess, or the required method to amortize, could cause a normalization violation. Please also see the response to Question 9.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION

Witness: **John R. Wilde**

- 17.** Identify any assets, property and accounts the depreciation of which gave rise to protected excess ADIT and:
- a. Provide the extent to which such assets, property, and accounts were depreciated as of December 31, 2017, in terms of percentage and total value;
 - b. Provide the annual depreciation schedule for each such asset, property, and account for tax and regulatory purposes through 2034;
 - c. Identify the date on which each such asset, property, and account will be fully depreciated under the current regulatory depreciation schedule;
 - d. Provide the excess ADIT that arose from the depreciation of each such asset, property, and account as of January 1, 2018;
 - e. Provide the total accumulated deferred income taxes, including excess accumulated deferred income taxes and accumulated deferred income taxes that are not excess, attributable to each such asset, property, and account as of December 31, 2017;
 - f. Identify and provide any other information used by you to calculate the maximum protected excess ADIT that may be reimbursed to ratepayers in 2018 through 2033 using the ARAM method;
 - g. If the information necessary to use the ARAM method is not available, please explain the method and basis for your calculation in response to the preceding Item; and
 - h. If estimates and assumptions were made to calculate the response to the preceding Item, please identify and describe any estimates and assumptions.

Response:

In general, what people commonly refer to as “protected” ADIT is the ADIT that results from the difference between tax depreciation, and depreciation re-computed on tax basis using the same method and same life as depreciation used for ratemaking purposes. This is commonly referred to as the “method / life” difference.

In addition, on a utility by utility basis, the ADIT that results from repairs differences may or may not be a “protected” difference. The reason for this is that when the repairs accounting method change was made, depending on the facts and circumstances surrounding the procedural issues of obtaining IRS consent, a taxpayer may have been required to agree to use a normalization method of accounting related to repair property. Specifically, American Water Works and each of its subsidiary companies, including KAW, were required to agree to use normalization related to its repairs, and therefore substantially all of KAW’s plant related differences are protected differences.

As stated in the response to No. 16, KAW does not have the detailed information requested using ARAM or RSGM. It will need to analyze its data further and implement the PowerTax deferred tax module in order to correctly calculate the protected excess deferred taxes and return to customers. Also please refer to the response to Question 9. KAW expects that it will be able to do this by the first or second quarter of 2019.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION

Witness: **John R. Wilde**

- 18.** Identify and describe the source of all unprotected excess ADIT, and if any excess unprotected ADIT arose from the depreciation of any property or account, please state the extent to which such property or account was depreciated as of December 31, 2017, in percentage terms and total value; identify the date on which each would be fully depreciated based on the current regulatory depreciation schedule; and identify the excess unprotected ADIT attributable to each such property or account as of January 1, 2018.

Response:

The source of all unprotected excess ADIT is anything not protected by IRS regulations, as explained in response to No. 17. The Company has not calculated Protected and Unprotected excess ADIT at this time and does not have the details requested. See also the response to Question 9.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION

Witness: **John R. Wilde**

- 19.** Please state the date on which your tax year runs, and identify and describe any effect that has on your calculation of the excess ADIT, the rate at which it may be reimbursed pursuant to the Tax Cut and Jobs Act, and any of your answers herein above.

Response:

KAW participates in the filing of the consolidated income tax return of American Water Works Company, Inc. The group's tax year is based on the calendar year. There may be minor effects on the calculation of excess ADIT since, for instance, the tax law was signed on 12/22/2017 and technically deferred taxes need to be re-measured on that date. In addition, bonus depreciation stops effective 09/27/2017. So additional analysis of Company assets needs to be performed to ensure that KAW is picking up all eligible assets.

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2018-00042
COMMISSION STAFF'S FIRST REQUEST FOR INFORMATION**

Witness: **Linda C. Bridwell**

- 20.** Provide all supporting schedules, calculations and documentation in Excel spreadsheet format with formulas intact and unprotected, and all rows and columns fully accessible.

Response:

All supporting schedules and calculations that were prepared in Excel have been provided in Excel format with formulas intact and unprotected, and all rows and columns fully accessible as attachments to the individual responses to these information requests. For Excel files supporting KAW's January 26, 2018 filing, please see the attached.