

STATE OF NEW JERSEY

BOARD OF PUBLIC UTILITIES

**In The Matter of the Petition of
Public Service Electric and Gas Company
for Approval of an Increase in Electric and Gas
Rates and For Changes In the Tariffs For Electric
And Gas Service, B.P.U.N.J. No. 16 Electric and
B.P.U.N.J. No. 16 Gas Pursuant to
N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1,
And For Other Appropriate Relief**

BPU Docket Nos. _____

**DIRECT TESTIMONY
OF
ROBERT C. KRUEGER, JR.**

**VICE-PRESIDENT – SPECIAL PROJECTS
PSEG SERVICES COMPANY**

January 12, 2018

P-4

Table of Contents

I.	INTRODUCTION	- 1 -
II.	THE IMPACT OF FEDERAL TAX LEGISLATION	- 3 -
III.	TAX EXPENSE AND ACCUMULATED DEFERRED INCOME TAXES	- 6 -
IV.	CONSOLIDATED TAX ADJUSTMENT	- 18 -

1 testimony, I discuss the consolidated tax ratemaking adjustment and present a computation of
2 that adjustment that is consistent with the recent Board decision in *I/M/O the Verified*
3 *Petition Of Jersey Central Power & Light Company For Review and Approval OF Increases*
4 *In And Other Adjustments To Its Rates And Other Charges For Electric Service*, BPU
5 Docket No. ER12111052, "Order Adopting Initial Decision With Modifications and
6 Clarifications" (March 26, 2013) at page 73.

7 **Q. Do you sponsor any schedules as part of your prepared testimony?**

8 A. Yes. I sponsor the following schedules that were prepared or compiled under my
9 direct supervision:

10 Schedule RCK-1 describes my professional qualifications and business
11 experience;

12
13 Schedule RCK-2 details two estimated adjustments we are making in this
14 filing to reflect the impact of certain aspects of the recently-enacted federal
15 tax reform legislation;

16
17 Schedule RCK-3 details the computation of income tax expense for electric
18 and gas for the test year;

19
20 Schedule RCK-4 details the computation of accumulated deferred income
21 taxes for electric and gas for the test year;

22
23 Schedule RCK-5 details three adjustments associated with Company's
24 proposal to flow-through to customers the tax benefit associated with the Safe
25 Harbor Adjusted Repair Expense deductions;

26
27 Confidential Schedule RCK-6A details the computation of the CTA; and

28
29 Confidential Schedule RCK-6B details the computation separating
30 transmission taxable income from electric taxable income

1 **II. THE IMPACT OF FEDERAL TAX LEGISLATION**

2 **Q. Does the recently enacted federal tax reform bill have implications for this rate**
3 **proceeding?**

4 A. Yes. On December 22, 2017, the President signed into law a bill entitled “To
5 provide for reconciliation pursuant to titles II and V of the concurrent resolution on the
6 budget for fiscal year 2018” bill, formerly known as the “Tax Cuts and Jobs Act” (the
7 “Act”). The Act contains many provisions that substantially modify the Internal Revenue
8 Code, and full quantification of its impacts will take some time. Below I have described the
9 major implications of the Act having current ratemaking consequences. We have not
10 updated this initial filing to reflect all of the impacts of the Act, as we need more time to fully
11 quantify them. However, we have reflected, as a pro forma test year adjustment, a high level
12 estimate of the impact of the change in the federal corporate income tax rate on operating tax
13 expense. In addition, we have included a high level estimate of the amount of over-
14 collection that will result under PSE&G’s current base rates due to the tax rate change for the
15 period January 1, 2018 through September 30, 2018 (the day prior to the date we expect new
16 rates to go into effect). PSE&G proposes to return this over-collection through our new Tax
17 Adjustment Credit (“TAC”), which is described in detail below. The computation of the
18 adjustments for the change in the federal corporate income tax rate on operating tax expense
19 and the over-collection that will result under PSE&G’s current base rates due to the tax rate
20 change for the period January 1, 2018 through September 30, 2018 is shown on schedule
21 RCK-2. Further, we will provide an update in our 9+3 filing to reflect all impacts of the Act
22 that can be reliably quantified.

1 **Q. Please describe the implications of the reduction in the federal corporate income**
2 **tax rate.**

3 A. The Act reduces the federal corporate income tax rate from 35% to 21%, effective
4 January 1, 2018. This rate change has a number of implications, including:

5 a. Reduces PSE&G's tax expense from January 1, 2018 through the date when new
6 base rates go into effect;

7 b. Increases PSE&G's test year operating income by lowering test period tax
8 expense;

9 c. A portion of PSE&G's existing Accumulated Deferred Income Tax ("ADIT")
10 balance becomes in excess of what is needed to offset future tax liabilities. These
11 excess deferred taxes fall into two categories – those restricted by the
12 normalization provisions of The Act (sometimes referred to as "protected"
13 ADIT), and those that are not (sometimes referred to as "unprotected" ADIT).
14 The restricted excess deferred taxes can be returned to customers, but no more
15 rapidly than over the Average Rate Assumption Method ("ARAM"). The ARAM
16 provision, which is essentially the same as the rule enacted in the Tax Reform Act
17 of 1986, provides for the reversal of excess ADIT on a vintage and class basis as
18 the related timing differences reverse, using the weighted average tax rate at
19 which deferred taxes were established. By way of contrast, the unrestricted
20 excess deferred taxes can be returned to customers over any reasonable period.
21 Note that any refund of rate base-related deferred taxes would result in a
22 corresponding increase in rate base and revenue requirement.

23 d. The Act will alter the after tax cost of debt as well as the revenue gross up factor
24 and the interest synchronization computation.

25 **Q. Does the Act also include a limitation of the deduction of interest expense?**

26 A. Yes, the Act has a provision limiting the deduction of interest. However, regulated
27 utilities are exempt from this provision. Therefore, there will be no loss of interest deduction
28 for PSE&G, and thus no resultant increase in tax.

1 **Q. How does the Act address accelerated and “bonus” depreciation?**

2 A. While the Act provides for 100% depreciation for capital expenditures beginning
3 September 27, 2017, regulated utilities are not eligible for this 100% expensing. Beginning
4 in 2018, only regular Modified Accelerated Cost Recovery System (MACRS) depreciation
5 may be claimed by regulated utilities. There is uncertainty in the Act as to whether some
6 bonus depreciation (either 50% or 100%) may be applied for the period from September 27
7 through December 31, 2017. However, we expect clarification of this rule prior to the
8 conclusion of this case. As noted above, the impact of this depreciation change is not
9 reflected in this filing. We will update our filing in our 9+3 submission based on the best
10 information available at that time.

11 **Q. Does the Act contain any other changes relevant to this case?**

12 A. Yes. There are a number of provisions that will impact the Company’s tax expense.
13 These provisions will be analyzed and we will update tax expense in our 9+3 submission.

14 **Q. Please summarize the impact of the Act that are reflected in this filing.**

15 A. We have incorporated into this base rate filing the impacts of items a. and b.
16 identified above with respect to the impact of the federal corporate tax rate reduction.
17 Specifically, we have (1) estimated the impact of the lower tax rate from January 1, 2018
18 through the establishment of new base rates, which will be deferred and returned to
19 customers via the TAC described below; and (2) lowered the test period tax expense used to
20 calculate PSE&G’s test year operating income through a pro forma adjustment resulting in
21 the application of the new, lower corporate tax rate across the entire test year. In addition,
22 we have adjusted the revenue gross-up factor to reflect the new, lower tax rates (see item d.

1 above regarding the impact of the federal corporate tax rate reduction). Other than these
2 items, the impacts of the Act are complicated to quantify; PSE&G will update this filing as
3 appropriate once we have solid computations of the additional impacts.

4 **Q. Will PSE&G's base rates following completion of this case ultimately reflect all**
5 **impacts of the Act?**

6 A. Yes. However, it will take time to fully analyze and quantify the impacts of all the
7 provisions. We will endeavor to quantify as much as we can, as soon as we can, and update
8 our filing accordingly. However, there may be details that require further clarification from
9 Congress or the IRS, or provisions that require system upgrades that may require an extended
10 period of time to complete. For those issues, we would propose that we reflect the impact of
11 those changes in rates, with the best information possible. Any subsequent changes, when
12 known, will be reflected through our proposed Tax Adjustment Credit described further
13 below.

14 **III. TAX EXPENSE AND ACCUMULATED DEFERRED INCOME TAXES**

15 **Q. Have you determined the appropriate income tax expense component of**
16 **operating income for the filed test period?**

17 A. Yes I have. I have computed a net total income tax expense of \$105.832 million for
18 electric and \$76.956 million for gas, comprised of a current tax expense of \$28.538 million
19 and (\$85.802) million for electric and gas, respectively, and a deferred tax expense of
20 \$124.657 million and \$199.279 million for electric and gas, respectively. The net total
21 income tax expense includes the two pro forma adjustments I am also proposing of (\$47.362)
22 million and (\$36.521) million for electric and gas, respectively, which I will describe in more

1 detail below. The details of this determination are shown on Schedule RCK-3, which shows
2 current tax expense and significant components of deferred tax expense. I provided this tax
3 expense to Mr. Jennings for inclusion in his Schedule SSJ-25.

4 **Q. Did you prepare a schedule showing the balance of Accumulated Deferred**
5 **Income Taxes (“ADIT”) associated with utility plant?**

6 A. Yes I did; it can be found at Schedule RCK-4. That schedule shows a proposed rate
7 base reduction of \$1.655 billion for electric and \$1.770 billion for gas as of December 31,
8 2018. In the schedule, I have broken utility plant related ADIT down into several categories
9 as follows:

10 Accelerated Depreciation and other - includes the Federal deferred taxes that
11 either arise or reverse through depreciation deductions (including bonus
12 depreciation) allowed pursuant to sections 167 and 168 of the Internal
13 Revenue Code and certain other plant related deductions such as cost of
14 removal.

15
16 Safe Harbor Adjusted Repair Expense (“SHARE”) deductions – includes
17 Federal deferred taxes associated with projects that are claimed as deductible
18 repair expenses pursuant to IRC section 162 but are capital assets for financial
19 reporting purposes.

20
21 NJ Corporation Business Tax – includes all deferred taxes provided for the NJ
22 Corporation Business Tax.

23
24 Further I’ve included a *pro forma* adjustment to ADIT related to Tax Repair
25 Deductions that is discussed in detail below. Mr. Jennings has reflected these deferred taxes
26 as a rate base reduction in Schedule SSJ-03.

27 **Q. Are there any adjustments that should be made to income taxes?**

28 A. Yes. The flow through of the federal tax benefit associated with the tax deduction of
29 the Asset Depreciation Range (“ADR”) Repair Allowance should be eliminated and replaced

1 with a flow through of the federal tax benefit for the new SHARE deduction via a new TAC
2 discussed below. Further, I propose a plan to return the accumulated ADIT associated with
3 the SHARE deduction to customers via the TAC as well.

4 **Q. Why do you propose eliminating the ADR Repair Allowance from operating**
5 **income?**

6 A. In short, because the Company no longer deducts the ADR Repair Allowance.

7 **Q. What is the ADR Repair Allowance?**

8 A. The ADR Repair Allowance is a deduction set out in Treasury Regulation 1.167-
9 11(d)(2). It provides that certain qualifying capital additions to property may be currently
10 deductible as an expense up to a defined cap. It only applies to additions to or replacements
11 of older units of property (placed in service prior to 1981). Because it only applied to these
12 older vintages of property and was capped, the size of the deduction was limited.

13 **Q. Why did the Company stop deducting the ADR Repair Allowance?**

14 A. On September 12, 2011, the Internal Revenue Service (“IRS”) released Revenue
15 Procedure 2011-43 (which was later modified in Revenue Procedure 2014-16), detailing a
16 safe harbor method for determining repair deductions for electric utilities. These rules apply
17 to all vintages of property and permit a significantly larger repair deduction than was
18 permitted under the ADR Repair Allowance rules. Section 5(7) of that Revenue Procedure
19 provides that taxpayers that wished to adopt the safe harbor method set out in the Revenue
20 Procedure were precluded from electing the ADR Repair Allowance. While we began
21 claiming enhanced repair deductions in 2010, the provision precluding the repair allowance
22 deduction had to be complied with for the 2014 tax year. Accordingly, because the repair

1 deduction under the new safe harbor provision was substantially larger than under the old
2 ADR Repair Allowance, effective in 2014 PSE&G adopted the SHARE deduction and did
3 not elect ADR Repair Allowance on our tax return for that year or any year since.

4 **Q. How do you propose that SHARE deduction impact ratemaking?**

5 A. Because the Board required PSE&G to flow through the ADR repair allowance
6 deduction in our case for ratemaking purposes, and because that ADR Repair deduction has
7 been replaced by the larger SHARE deduction, we now propose to flow back to customers
8 the SHARE deduction in place of the ADR repair allowance deduction.

9 **Q. What is deferred tax accounting and how does it differ from flow-thru**
10 **accounting?**

11 A. Generally Accepted Accounting Principles (“GAAP),” now codified as ASC 740,
12 require comprehensive inter-period tax allocation for all temporary differences between book
13 and tax accounting. Simply stated, a temporary difference is an item of income or expense,
14 for which the difference in basis or timing of recognition in income differs between tax
15 purposes and financial reporting purposes. When a temporary difference is reflected in the
16 computation of taxable income in a different period than it is for financial reporting purposes,
17 there is an impact on the timing of taxation, and GAAP requires that a deferred tax expense
18 or benefit be recorded on the income statement to reflect the future reversal of that temporary
19 difference. A deferred tax expense results in an increase in ADIT liabilities on the balance
20 sheet, and the liability reverses as the Company repays the temporary benefit to the
21 government in the form of higher tax payments in the future. This is what I refer to as
22 deferred tax accounting.

1 **Q. Has the Board ever decided not to use deferred tax accounting?**

2 A. In some cases, the Board has chosen not to recognize these deferred tax impacts for
3 ratemaking purposes, allowing the impact in the current period tax return to flow through to
4 the income statement and be recognized currently for ratemaking purposes. This choice to
5 not allow deferred taxes in the computation of utility tax expense for ratemaking is what I
6 refer to as “flow through accounting.”

7 **Q. Can you describe flow through accounting?**

8 A. To say it simply, flow through accounting puts the utility on a tax return basis (cash
9 basis) for tax recovery in the ratemaking process. Tax expense or benefit of the particular
10 item will flow to customers in the year in which the taxes are reflected in the tax return.
11 Deferred tax accounting, in contrast, matches the tax impact of an item of expense or income
12 with the recovery of that item from customers.

13 **Q. Please provide an example of the difference between flow through and deferred**
14 **tax accounting.**

15 A. A classic example is the Allowance for Doubtful Accounts (also known as
16 uncollectible expense). For financial reporting purposes, an expense is accrued each year
17 related to the accounts receivable from customers estimating the amount of those receivables
18 that will ultimately be uncollectable. For tax purposes, this reserve is not deductible until
19 specific accounts receivable actually are declared uncollectable and abandoned. This
20 typically happens in a year after the book reserve was accrued.

21 For example, assume in year 1 that a \$1,000 expense is accrued on the books related
22 to estimated uncollectable accounts. For tax purposes, this expense is not deductible in year

1 1, so an adjustment is made in the tax return to disallow that book deduction. Accordingly,
2 there will be no current tax benefit for that \$1,000 reserve in Year 1. In year 2, assume the
3 actual account is written off and the \$1,000 then becomes deductible in the tax return in year
4 2 resulting in a \$350 tax benefit in year 2 (\$1,000 deduction times the 35% Federal tax rate).

5 If flow through accounting is employed, the full \$1,000 bad debt reserve would be
6 charged to utility customers in year 1 and the \$350 tax benefit would be passed to customers
7 in year 2 because that is the year in which the FIT deduction would be recognized. If
8 deferred tax accounting is employed, a \$350 deferred tax benefit would be recorded in year
9 1, and the amount charged to customers in year 1 would be \$650 (\$1,000 less the \$350
10 deferred tax benefit). There would be no customer impact in Year 2.

11 **Q. Would the flow through of the SHARE deduction jeopardize the Company's**
12 **ability to claim that or any other deductions?**

13 A. No, it would not. Unlike accelerated depreciation, for example, the SHARE
14 deduction is not within the scope of the IRS normalization rules, so deferred tax accounting
15 is not an IRS requirement. Moreover, flowing this tax benefit through to our customers is
16 consistent with PSE&G's past Board Order in Docket Number ER85121163. If, as that
17 Order establishes, it was permissible to flow through one type of repair deduction, it follows
18 that the SHARE deduction could also be flowed through to customers.

19 **Q. How much larger is the SHARE than the ADR Repair Allowance?**

20 A. For the period 2010 through 2015, the total ADR Repair Allowance deduction was
21 approximately \$300 million versus the total SHARE deduction of approximately \$1.7 billion,

1 which includes a one-time change in accounting method adjustment. Clearly the larger
2 deduction is in the Company's and customers' best interests, so we changed to the SHARE.

3 **Q. Is either the flow-through or deferred tax accounting method required?**

4 A. With two exceptions, neither method is required in setting rates. The first exception
5 is for ratemaking purposes, deferred tax accounting is required when the normalization rules
6 of the Internal Revenue Code ("IRC") apply. Under those rules, the deduction for
7 accelerated depreciation will be forfeited if the benefit is flowed through to customers instead
8 of being normalized. These rules however, specifically apply only to deductions associated
9 with accelerated depreciation claimed pursuant to IRC sections 167 and 168. The
10 normalization rules do not apply to deductions claimed under any other section of the Code.
11 The SHARE deduction is not claimed under either of those IRC sections, so normalization is
12 not required for this repair deduction for federal income tax purposes.

13 The second exception is that NJSA 48:2-21.34 requires deferred tax accounting in
14 setting utility rates for all temporary differences used in computing New Jersey ("NJ") State
15 income tax. So no ADIT computed at the NJ rate may be flowed through. Therefore,
16 normalization would be required for the NJ State income tax portion of the SHARE
17 deduction.

18 **Q. Is one method to be preferred over the other?**

19 A. Arguments can be made for each method of ratemaking, and the choice should be
20 determined based upon company specific facts and circumstances. On the one hand, deferred
21 tax accounting is consistent with GAAP and matches an expense with its related tax benefit,
22 ensuring that a customer who pays for a particular expense also receives the related tax

1 benefit. Further, for utilities that are in need of cash flow, deferred tax accounting can
2 provide cash by allowing the utility to retain the cash benefit of accelerated deductions for a
3 longer period of time (resulting, of course, in higher rates in the near term).

4 On the other hand, it has been argued that customers should not be billed a tax
5 expense that the Company has not yet paid to the federal government. Deferred taxes by
6 their nature are not paid to the government until a future period. Where a company's cash
7 position is relatively sound, it may be more appropriate to not collect deferred taxes from
8 customers until they are actually due and payable to the taxing authority. Both methods are
9 widely employed across the country and have been employed by PSE&G.

10 **Q. When PSE&G initially claimed the SHARE deduction, did the Company**
11 **provide deferred taxes on that deduction and, if so, why?**

12 A. Generally, we did. We did so because GAAP requires the deferred tax method of
13 accounting for *temporary* differences. Only a specific order of the Board can cause a tax
14 adjustment to be flowed through in the financial statements. Consequently, we reviewed our
15 prior Board orders and concluded they applied only to an amount of repair deduction
16 attributable to the ADR Repair Allowance, not to the larger SHARE deduction.
17 Nevertheless, it was apparent the SHARE deduction and the ADR repair allowance are
18 similar in nature as they both relate to deducting similar costs as repair costs for tax purposes.
19 In fact, the ADR repair allowance is a subset of the larger SHARE deduction. Accordingly,
20 we continued to flow through a portion of the SHARE deduction that was equal to the ADR
21 repair allowance deduction. Deferred taxes were provided on the balance of the SHARE
22 deduction.

1 **Q. How do you propose to implement the flow through adjustment?**

2 A. The Company proposes to implement this adjustment in three separate pieces:

3 1. A *pro forma* adjustment to test period tax expense;

4 2. A *pro forma* adjustment to accumulated deferred taxes; and

5 3. The creation of a tax adjustment credit to flow through the current
6 SHARE benefit and to amortize the remaining balance of SHARE
7 related ADIT back to customers.

8

9 I will describe each of these in more detail.

10 **1. Pro forma adjustment to test period tax expense.**

11 Schedule RCK-5 – Adjustment 1, shows the computation of the *pro forma* adjustment
12 to eliminate the flow through tax benefit of the ADR repair allowance. While this adjustment
13 will eliminate the flow-through benefit of the ADR repair allowance from base rates, the
14 entire SHARE deduction, which includes the ADR repair allowance currently being flowed
15 through to customers for ratemaking purposes, will be flowed through to customers through
16 the proposed TAC. This adjustment effectively removes the tax benefit of the ADR Repair
17 allowance deduction net of the related book depreciation for the test period. I have not
18 modified test period tax expense for the flow through of the SHARE deduction as that will be
19 included in the proposed TAC discussed below. I have adjusted my test period tax expense
20 in RCK-2 by the adjustment computed in RCK-5, Adjustment 1.

21 **2. Pro forma adjustment to accumulated deferred taxes.**

22 Schedule RCK-5 – Adjustment 2, shows the computation of a *pro forma* adjustment
23 to ADIT. I propose that PSE&G's after tax deferred storm costs and certain other regulatory
24 assets (discussed in the testimony of Mr. Jennings) be offset with SHARE related ADIT.

1 This ADIT represents cash already recovered from customers. Rather than returning all of it
2 to customers through rate credits and then increasing rates to recover storm costs and other
3 regulatory assets, we propose to offset a portion of the SHARE ADIT with after tax storm
4 and other regulatory asset costs, thereby recovering those costs without increasing current
5 rates. As a result of this offset, the balance of ADIT associated with rate base decreases by
6 the offset. I have reflected the result of this *pro forma* adjustment on Schedule RCK-4.

7 **3. Flow through of the current SHARE deduction, Amortization and Flow**
8 **Through of the Remaining ADIT related to the SHARE deduction and trueing**
9 **up amounts in the future through a tax adjustment charge or credit.**

10 I propose that the flow through of the estimated current period SHARE tax benefit as
11 well as the remaining SHARE related ADIT, net of the resultant change in return-related
12 revenue requirement, be accomplished by the creation of a tax adjustment credit. This credit
13 would also be used to true up amounts in the future. The remaining SHARE related ADIT
14 will be the balance at the time new rates are implemented from this proceeding, proposed as
15 October 1, 2018. If rates are approved earlier or later than this date, the Company will flow-
16 through the actual SHARE related ADIT at the time rates are implemented. The amounts to
17 be included in the credit are shown in Schedule RCK-5, Adjustment 3.

18 **Q. Why are you proposing that the flow through be accomplished through the use**
19 **of an adjustment credit?**

20 A. I propose the creation of a tax adjustment credit, to be adjusted annually, in order to
21 serve the following purposes:

22 a. This would be the mechanism to return the unamortized balance of repair related
23 ADIT, after storm and other regulatory asset cost offsets, to customers. I propose

1 a rate adjustment to amortize the balance of remaining SHARE ADIT, net of the
2 return impact due to the change in ADIT, through this credit mechanism over a
3 five year period as described in more detail in the testimony of Mr. Swetz. The
4 amortization pattern was developed by Mr. Swetz and was optimized so that it
5 would help reduce the projected rate impacts of the Company's pending GSMP II
6 proposal. Use of the credit permits a changing pattern of amortization. The
7 actual computation of the initial revenue credit and the operational details of the
8 TAC are detailed in the testimony of Mr. Swetz.

9 b. The TAC would also serve as a mechanism to more accurately reflect in rates on
10 an annual basis the current period SHARE deduction benefit each year and true it
11 up to actuals in the following year. The repair deduction has the potential to vary
12 significantly from year to year based on the mix of capital projects undertaken.
13 Swings in the tens of millions of SHARE-related benefits year to year are
14 possible. In order to ensure that our customers get the full benefit of the SHARE
15 deduction, we propose the TAC to ensure rates are accurate and are trued up
16 annually for actual repair deductions. The mechanics of the TAC are discussed in
17 Mr. Swetz's testimony.

18 c. The TAC would further provide a mechanism that will permit the recovery of IRS
19 audit adjustments, if any. While the IRS has not yet challenged our SHARE
20 deductions, tax deductions of this magnitude are routinely scrutinized. Given the
21 size of these deductions and the IRS's policy of auditing multiple years at a time,
22 a final disallowance could be material. Because the tax benefit of any deductions

1 will have already been passed to customers, any IRS disallowance and interest
2 thereon would need to be recovered from customers. The TAC will provide the
3 mechanism to ensure timely recovery.

4 **Q. What are the benefits associated with the TAC that you are proposing?**

5 A. Utilizing the annually adjusted credit has several benefits. First, it allows for an
6 uneven method of amortization, which we could not do in a traditional base rate amortization
7 without an annual base rate case. It also permits flow through of the annual best estimate of
8 the current period SHARE benefit as well as the true-up to actual SHARE deductions to
9 ensure customers receive the full flow through benefit. Finally, it provides a mechanism to
10 stop the amortization of historical ADIT once the repair related ADIT is fully returned to
11 customers, in order to avoid possible IRS normalization violations. If we were to over-
12 amortize the SHARE deduction related ADIT balance, the excess amortization arguably
13 would come from the depreciation related ADIT, which is protected by the normalization
14 rules. Reversing that deferred tax would result in a normalization violation and the possibility
15 of significant penalties. Use of the TAC avoids that risk entirely.

16 **Q. Is there any other benefit associated with the TAC you're advocating?**

17 A. Yes. The TAC is a mechanism we suggest using to address other major tax changes
18 now (i.e., the changes occasioned by the Act described above) or in the future.

19 **Q. Why do you propose to flow through only the federal deferred tax related to the**
20 **SHARE deduction?**

21 A. As noted above, N.J.S.A. 48:2-21.34 requires deferred tax accounting in setting utility
22 rates for all temporary differences in computing New Jersey State income tax. Accordingly,

1 as the New Jersey statute does not allow for flow through, we are not proposing the flow
2 through of the state deferred taxes.

3 **IV. CONSOLIDATED TAX ADJUSTMENT**

4 **Q. What is a Consolidated Tax Adjustment?**

5 A. In the simplest terms, a Consolidated Tax Adjustment (“CTA”) is a ratemaking
6 adjustment designed to pass some or all of the benefit of tax savings generated by
7 nonregulated subsidiaries of a consolidated return filing group to the regulated affiliate.

8 **Q. Has the Board ever issued an order mandating a CTA in a previous PSE&G rate**
9 **case?**

10 A. No. Although the Office of the Ratepayer Advocate has proposed a CTA in many of
11 PSE&G’s rate proceedings, all of those cases were settled without specific resolution of the
12 CTA.

13 **Q. Do you believe that the imposition of a CTA is appropriate?**

14 A. No I do not. I and others representing PSE&G have testified several times in New
15 Jersey about the flaws of the CTA adjustment. I continue to believe the imposition of a CTA
16 is an inappropriate regulatory adjustment.

17 **Q. Has the Board purported to revise its policy regarding CTAs since PSE&G’s last**
18 **rate case?**

19 A. Yes it has. On January 23, 2014 the Board issued an order opening Docket
20 EO12121072, a generic proceeding to review the applicability and computation of the CTA.
21 On November 22, 2014 the Board issued an order (“November 22 Order”) in that docket
22 setting out key computational requirements with respect to the CTA. Those requirements

1 represented a significant change from computations that had been approved by the Board in
2 the past. The order in this generic proceeding was ultimately reversed on appeal. I am
3 advised by counsel that that reversal was on “procedural grounds”; the court provided no
4 opinion regarding the computational requirements the Board has recently set out. However,
5 the Board has issued a decision in a litigated proceeding that is consistent with its November
6 22 Order in *I/M/O the Verified Petition Of Jersey Central Power & Light Company For*
7 *Review and Approval OF Increases In And Other Adjustments To Its Rates And Other*
8 *Charges For Electric Service*, BPU Docket No. ER12111052, "Order Adopting Initial
9 Decision With Modifications and Clarifications" (March 26, 2013) at page 73. It is my
10 understanding that this decision was not affected by the reversal of the November 22 Order.
11 In addition, at its December 19, 2017 agenda meeting, the Board adopted a proposed formal
12 rule codifying use of this method going forward.

13 **Q. Please briefly describe these computational requirements and how they differ**
14 **from past computations?**

15 A. The computational requirements are:

- 16 1. The calculation period for the CTA shall include a look back period of five
17 calendar years, including any complete year that is included in the test year. The
18 Board’s previous orders for other companies had approved a lookback period
19 beginning in 1991 continuing through the test period.
20
- 21 2. The calculated tax adjustment based on the review period shall be allocated so
22 that the revenue requirement of the company is reduced by 25% of the
23 adjustment. In the past, the Board has approved revenue requirement reduction of
24 100% of the computed adjustment.
25
- 26 3. Transmission assets of the Electric Distribution Companies would not be included
27 in the calculation of the CTA. In past orders, the Board did not make this
28 distinction.

1 **Q. Have you included a computation of the CTA that is consistent with the JCP&L**
2 **Order?**

3 A. Yes I have. In Confidential Schedule RCK-6A and 6B, which will be provided
4 following execution of a Confidentiality Agreement, I have provided data dating back to
5 1991 consistent with data we provided in the CTA generic proceeding, updated for settled
6 IRS audits. Confidential Schedule RCK-6A presents the computation of the CTA and
7 Confidential Schedule RCK-6B presents the computation separating transmission taxable
8 income from electric taxable income. I then computed a CTA using this data in accordance
9 with the JCP&L Order. The resulting CTA is a reduction of rate base equal to \$1.3 million
10 for electric and an increase of \$0.6 million for gas. Mr. Jennings has included this amount in
11 rate base as shown in Schedule SSJ-03.

12 **Q. Notwithstanding the Board's recent decisions concerning the CTA, do you**
13 **believe this is an appropriate adjustment to make?**

14 A. No I do not. I have always believed and continue to believe that the CTA is an
15 inappropriate ratemaking adjustment and the practice should be eliminated, as it has been in
16 most states. Nevertheless, the Company has computed and provided an adjustment
17 consistent with the JCP&L Order.

18 **Q. Does this conclude your testimony at this time?**

19 A. Yes, it does.

QUALIFICATIONS OF
ROBERT C. KRUEGER, JR.

Educational Background

In 1982 I graduated from Bucknell University with a Bachelor of Science in Business Administration – Accounting Degree. In 1983, I earned the degree of Master of Business Administration from Lehigh University. I have been a licensed Certified Public Accountant in the State of New Jersey since 1985.

Work Experience

Between 1983 and 1988, I was employed by the accounting firm of Deloitte, Haskins, and Sells (DH&S) and performed general auditing and tax accounting. I commenced employment with Public Service Electric and Gas Company (PSE&G) in 1988 as a Principal Tax Account. In 1992, I was promoted to Director – Tax Services, where I was responsible for tax compliance, as well as accounting and planning activities. In 1999, I was promoted to Director – Financial Planning and Analysis, responsible for business forecasting and budgeting. In 2000, I assumed the responsibility for analysis of accounting and tax strategies for PSE&G and Public Service Enterprise Group Incorporated. In 2006, I was promoted to Vice-President and Assistant Controller – Tax and have been responsible for all tax matters of the Enterprise Group. Effective January 1, 2018, I was assigned the role of Vice President – Special Projects.

I am a member of the American Institute of Certified Public Accountants and the New Jersey State Society of Certified Public Accountants.

I have testified before the New Jersey Board of Public Utilities (NJBPU) during the PSE&G Energy Master Plan Phase II proceeding, whereby the NJBPU conducted investigations

into the future structure of the electric power industry. I have also testified in the 2001 PSE&G

Gas Base Rate Case proceeding. In both of these rate proceedings, I served as the PSE&G accounting witness, responsible for all accounting and tax-related issues. I also provided rebuttal testimony in PSE&G's 2009 base rate case.

In 2002, I was appointed by the Governor of the State of New Jersey, James E. McGreevey, to the New Jersey Corporate Business Tax Study Commission. I served on this Commission until June of 2004, when the Commission issued its final report.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY

ESTIMATED IMPACT OF TAX REFORM
(\$000's)

Adjustment 1

Proforma Adjustment to Test Period Tax Expense

Restate Tax expense to reflect the new rate

	<u>Estimated Federal</u>	<u>Estimated State</u>	<u>Estimated Federal Benefit of State</u>	<u>Total</u>
Electric				
Current Tax at current rate	27,696	1,295	(453)	28,538
Current Tax at New rates	16,618	1,295	(272)	17,641
Change in Deferred Tax due to Tax Reform	(11,078)	-	181	(10,897)
Deferred Tax at current rate	108,495	24,665	(8,633)	124,527
Deferred Tax at New Rates	65,097	24,665	(5,180)	84,582
Change in Deferred Tax due to Tax Reform	(43,398)	-	3,453	(39,945)
Adjust Repair allowance Proforma	(2,320)			(2,320)
Electric				
Total Adjustment to Operating Tax expense due to change in tax rate	(56,796)	-	3,634	(53,162)

	<u>Estimated Federal</u>	<u>Estimated State</u>	<u>Estimated Federal Benefit of State</u>	<u>Total</u>
Gas				
Current Tax at current rate	(77,111)	(13,371)	4,680	(85,802)
Current Tax at New rates	(46,267)	(13,371)	2,808	(56,830)
Change in Deferred Tax due to Tax Reform	30,844	-	(1,872)	28,973
Deferred Tax at current rate	179,231	32,584	(11,405)	200,411
Deferred Tax at New Rates	107,539	32,584	(6,843)	133,280
Change in Deferred Tax due to Tax Reform	(71,692)	-	4,562	(67,131)
Adjust Repair allowance Proforma	(1,091)			(1,091)
Gas				
Total Adjustment to Operating Tax expense due to change in tax rate	(41,939)	-	2,690	(39,249)

Adjustment 2

Estimated Tax Overcollections Due to Tax Rate Change from January 1, 2018 to September 30, 2018.

To be refunded via the Tax Adjustment Clause

	<u>Electric</u>	<u>Gas</u>	<u>Total</u>
Pre-Tax Income (Jan-Sep 2018)	(411,246)	(163,432)	(574,678)
Less AFUDC-Equity	4,525	559	5,084
Pre-Tax Income Excluding AFUDC-Equity	(406,721)	(162,873)	(569,594)
Income Taxes @ 40.85%	(166,146)	(66,534)	(232,679)
Income Taxes @28.11%	(114,329)	(45,784)	(160,113)
Income Tax Deferral to be Added to TAC	(51,816)	(20,750)	(72,566)

PUBLIC SERVICE ELECTRIC AND GAS COMPANY

CURRENT AND DEFERRED INCOME TAXES

(\$000)

Line		Test year ended 6/30/18		
		Electric	Gas	Total
1	<u>Current</u>			
2	Federal	\$ 27,243	\$ (72,431)	\$ (45,189)
3	State	1,295	(13,371)	(12,076)
4	Total Current	\$ 28,538	\$ (85,802)	\$ (57,264)
5	<u>Deferred</u>			
6	Depreciation and Other - federal	100,896	106,634	207,530
7	Repair - federal	7,717	60,983	68,701
8	State - plant related	27,137	32,525	59,663
9	Loss on Reacquired Debt	(692)	(268)	(960)
10	Clause - RAC (Environmental Clean Up)	(2,200)	(3,737)	(5,937)
11	Clause - Societal Benefits Clause (AAP)	(1,105)	(952)	(2,057)
12	Clause - Deferred Fuel	(3,070)	-	(3,070)
13	Contributions in Aid of Construction	(7,696)	(585)	(8,281)
14	Pension - Tax Deduction	3,614	4,153	7,767
15	OPEB - Tax Deduction	1,226	4,807	6,033
16	Other	(52)	(3,313)	(3,365)
17	Total Deferred	\$ 125,776	\$ 200,247	\$ 326,023
18	Investment Tax Credit Amortized	(1,120)	(968)	(2,088)
19	Net Income Taxes	\$ 153,194	\$ 113,477	\$ 266,671
	<u>Proforma Adjustments:</u>			
20	Remove ADR Repair Allowance - RCK-5 Adj 1.	5,799	2,728	8,527
21	Adjust Test Year Taxes for Tax Act- RCK-2 Adj 1.	(53,162)	(39,249)	(92,411)
22	Adjusted income taxes	\$ 105,832	\$ 76,956	\$ 182,788

Note: the above is based on the historical 35% federal tax rate. It does not reflect the lower 21% federal tax rate that became effective 1/1/2018.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY

ACCUMULATED DEFERRED TAXES - ELECTRIC
(\$000)

	Estimated Balance 6/30/18	Activity	Estimated Balance 12/31/18
Depreciation & Other	\$ (1,317,436)	\$ (51,924)	\$ (1,369,360)
Repair Deduction	\$ (212,008)	\$ (2,542)	\$ (214,550)
NJ Corporate Business Tax	\$ (193,930)	\$ (16,839)	\$ (210,769)
Total Electric Accumulated Deferred Taxes	\$ (1,723,374)	\$ (71,305)	\$ (1,794,679)
<u>Proforma Adjustments:</u>			
Repair Deduction Flow thru - RCK-5 Adj 2.	\$ 139,281	\$ -	\$ 139,281
Adjusted Electric Accumulated Deferred Taxes	\$ (1,584,092)	\$ (71,305)	\$ (1,655,398)

ACCUMULATED DEFERRED TAXES - GAS
(\$000)

	Estimated Balance 6/30/18	Activity	Estimated Balance 12/31/18
Depreciation & Other	\$ (1,089,784)	\$ (57,724)	\$ (1,147,508)
Repair Deduction	\$ (418,504)	\$ (15,079)	\$ (433,583)
NJ Corporate Business Tax	\$ (187,532)	\$ (11,167)	\$ (198,698)
Total Gas Accumulated Deferred Taxes	\$ (1,695,819)	\$ (83,970)	\$ (1,779,790)
<u>Proforma Adjustments:</u>			
Repair Deduction Flow thru - RCK-5 Adj 2.	\$ 10,100	\$ -	\$ 10,100
Adjusted Electric Accumulated Deferred Taxes	\$ (1,685,719)	\$ (83,970)	\$ (1,769,690)

Note: the above is based on the historical 35% federal tax rate. It does not reflect the lower 21% federal tax rate that became effective 1/1/2018.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY

ADJUSTMENTS RELATED TO THE CONVERSION FROM ADR REPAIR ALLOWANCE TO SAFE HARBOR REPAIRS
(\$000's)

Adjustment 1	<u>Electric</u>	<u>Gas</u>	<u>Total</u>
<u>Proforma Adjustment to Test Period Tax Expense</u>			
<u>Remove ADR Repair Allowance flow Through</u>			
ADR Repair Allowance deduction included in the test period	(33,000)	(10,290)	(43,290)
Book Depreciation associated with ADR Repair Allowance property	16,431	2,496	18,927
Net flow through deduction included in test period	(16,569)	(7,794)	(24,363)
Federal Statutory Tax Rate	35.0%	35.0%	35.0%
ADIT needed to normalize ADR Repair allowance - Proforma adjustment to test year tax expense - To RCK-3	5,799	2,728	8,527
Adjustment 2	<u>Electric</u>	<u>Gas</u>	<u>Total</u>
<u>Proforma Adjustment to Accumulated Deferred Income Tax</u>			
<u>Offset Deferred Storm Costs with ADIT from Safe Harbor Repairs</u>			
Projected ADIT balance at 12/31/18 for Safe Harbor Repairs	(214,550)	(433,583)	(648,133)
Offset Deferred Storm Costs	233,333	7,565	240,898
Offset other Regulatory Assets	2,138	9,510	11,648
Offset Related Deferred Tax at 40.85%	(96,190)	(6,975)	(103,165)
Remaining projected ADIT balance at 12/31/18 for Safe Harbor Repairs	(75,269)	(423,483)	(498,752)
Adjustment Required to Plant Related Accumulated Deferred Income tax - To RCK-4	139,281	10,100	149,381
Adjustment 3	<u>Electric</u>	<u>Gas</u>	<u>Total</u>
SHARE Tax adjustments to be flowed through via the Tax Adjustment Clause			
<u>2019 Current Period SHARE Flow Thru Benefit</u>			
2019 Period Estimate of SHARE tax deduction (excluding repair allowance)	(12,391)	(172,342)	(184,733)
2019 Period Estimate of ADR Repair Allowance deduction	(33,000)	(10,000)	(43,290)
2019 Period Estimated Total SHARE Deduction	(45,391)	(182,342)	(228,023)
2019 Period Estimate of book depreciation associated with SHARE property	13,824	26,235	40,058
2019 Period Estimate of book depreciation associated with Repair Allowance property	15,211	2,442	17,653
2019 Period Estimated Total SHARE Book Depreciation	29,034	28,676	57,711
Net flow through deduction to be included in the Tax Adjustment Clause	(16,357)	(153,665)	(170,312)
Accumulated Deferred Income tax after storm offset to be amortized in the Tax Adjustment Clause (See Adjustment 2)	(75,269)	(423,483)	(498,752)

Note: the above is based on the historical 35% federal tax rate. It does not reflect the lower 21% federal tax rate that became effective 1/1/2018.