

Exhibit No.:  
Issue: Income Taxes  
Witness: Salvatore P. Montalbano  
Type of Exhibit: Surrebuttal Testimony  
Sponsoring Party: Kansas City Power & Light Company  
Case No.: ER-2012-0174  
Date Testimony Prepared: October 8, 2012

Filed  
November 30, 2012  
Data Center  
Missouri Public  
Service Commission

**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO.: ER-2012-0174**

**SURREBUTTAL TESTIMONY**

**OF**

**SALVATORE P. MONTALBANO**

**ON BEHALF OF**

**KANSAS CITY POWER & LIGHT COMPANY**

**Kansas City, Missouri  
October 2012**

KCP&L Exhibit No. 36  
Date 10-29-12 Reporter KF  
File No. ER-2012-0174

**SURREBUTTAL TESTIMONY**

**OF**

**SALVATORE P. MONTALBANO**

**Case No. ER-2012-0174**

1 **Q: Please state your name and business address.**

2 A: My name is Salvatore P. Montalbano. My business address is 1100 Walnut Street, Suite  
3 1300, Kansas City, Missouri, 64106.

4 **Q: Are you the same Salvatore P. Montalbano who pre-filed Direct and Rebuttal**  
5 **Testimony in this matter?**

6 A: Yes, I am.

7 *Purpose and Summary of Testimony*

8 **Q: What is the purpose of your Surrebuttal Testimony?**

9 A: My Surrebuttal Testimony addresses the portion of the Rebuttal Testimony of Mr. Cary  
10 G. Featherstone of the Missouri Public Service Commission ("MPSC" or the  
11 "Commission") Staff ("Staff") addressing Iatan 2 Advanced Coal Credits ("New ITCs").

12 **Q: More specifically, what subject matter does your testimony address?**

13 A: My Surrebuttal Testimony discusses the federal income tax risks associated with Mr.  
14 Featherstone's contention that the Commission adopt the MPSC Staff's recommendations  
15 found at page 195 of Staff's Staff's Revenue Requirement/Cost of Service Report for the  
16 Kansas City Power & Light Company ("KCP&L" or the "Company") rate case. My  
17 Surrebuttal Testimony further expounds upon the findings made in my Rebuttal  
18 Testimony and explains why Mr. Featherstone's recommendations may create a potential  
19 loss of credits for KCP&L and KCP&L Greater Missouri Operations Company ("GMO").

1 ***Background Facts on New ITCs***

2 **Q: Have the background facts surrounding the New ITCs changed from your Direct or**  
3 **Rebuttal Testimonies?**

4 A: No. Please see my Direct Testimony and/or Rebuttal Testimony surrounding the facts  
5 explaining how KCP&L was allocated New ITCs but GMO has not actually been  
6 allocated any of the New ITCs.

7 **Q: What is Staff recommending on page 195 of its Cost of Service Report for the**  
8 **KCP&L rate case (Case No. ER-2012-0174)?**

9 A: Staff recommends the Commission order the reallocation of New ITCs between KCP&L  
10 and GMO, or at least order Great Plains Energy Incorporated ("GPE") to request a  
11 reallocation from the Internal Revenue Service ("IRS") of New ITCs between KCP&L  
12 and GMO. If the IRS does not reallocate the New ITCs, Staff suggests KCP&L should  
13 pay the monetary equivalent to GMO of its proposed respective share of New ITCs.  
14 Alternatively, Staff recommends that the Commission could disallow the allocation of  
15 GPE, KCP&L and GMO officers' salaries and benefits to GMO. The recommended  
16 disallowed officers' salaries and benefits are \$617,857 for GMO-MPS and \$269,445 for  
17 GMO-L&P.<sup>1</sup> Alternatively, if the Commission does not agree with either allocating  
18 credits or a monetary equivalent of the credits to GMO or removing officers' salaries and  
19 benefits from GMO's cost of service, Staff recommends the Commission adjust the return  
20 on equity for KCP&L and GMO.

---

<sup>1</sup> GMO contains the activities of two operating divisions, Missouri Public Service ("GMO-MPS") and St. Joseph Light & Power ("GMO-L&P").

1 **Q: From these facts, what did your Rebuttal Testimony conclude?**

2 A: A reallocation of new ITCs from KCP&L to GMO could constitute a normalization  
3 violation under Internal Revenue Code ("IRC") Section 50(d)(2) and former IRC Section  
4 46(f)(2). Moreover, all the other proposals recommended by Staff could constitute  
5 normalization violations.

6 **Q: Why did your Rebuttal Testimony indicate that all of Staff's proposals constitute**  
7 **normalization violations?**

8 A: Treas. Reg. Section 1.46-6(b)(4) prohibits any reduction in cost of service or rate base if  
9 it cannot be done directly. Therefore, no matter how Staff tries to craft it: as a direct re-  
10 allocation, as a monetary equivalent, as an equivalent reduction in officers' salaries and  
11 benefits in cost of service or as a reduction in the rate of return, it is clear that Staff is  
12 suggesting that GMO receive indirectly the benefits of the New ITCs that it has never  
13 received from the IRS. Any of these attempts could be deemed a normalization violation.  
14 I referred to Private Letter Ruling ("PLR") 200945006.<sup>2</sup> PLR 200945006 involved the  
15 sale of natural gas assets of a public utility to another unrelated public utility. The  
16 regulatory commission in question sought to require the seller to transfer to the buyer the  
17 balance of its then-existing accumulated deferred investment tax credit ("ITC") as part of  
18 the transaction, or, in the alternative, that seller transfer amounts to buyer in lieu of the  
19 annual ITC amortization for purposes of flowing through those amounts to the ratepayers  
20 of the buyer. The IRS ruled that such a transfer of the unamortized ITC balance (or an  
21 amount in lieu of the actual ITC) and continued amortization by the buyer would violate  
22 the normalization rules.

---

<sup>2</sup> Although a PLR is technically only authority to the taxpayer to whom it is issued, the IRS follows a consistent policy in issuing PLRs on similar issues to other taxpayers.

1 The IRS objected to the fact that the buyer would be flowing through to its ratepayers  
2 ITC that was not available to, and was not claimed by, the buyer. Consequently, the  
3 buyer would have received no tax benefits of the investment credit but it would be forced  
4 to give a nonexistent benefit to its ratepayers. Like the buyer in PLR 200945006, under  
5 the Staff's proposals, GMO would receive no actual ITC but its ratepayers would be  
6 receiving the benefit of the ITC.

7 **Q: What was your conclusion in your Direct and Rebuttal Testimonies should a**  
8 **normalization violation be found to exist here?**

9 A: My testimonies indicated that if a normalization violation were deemed to exist, any  
10 reallocated credits could be lost. Congress mandated certain penalties in Section 211(b)  
11 of the Tax Reform Act of 1986. The penalty is the recapture and payment to the IRS of  
12 the greater of ITCs claimed in any open tax years or any unamortized ITC (for option 2  
13 companies), or ITCs not restored to rate base (for option 1 companies), remaining on its  
14 regulated books.

15 Under the penalty provisions, the \$3.2 million in deferred ITC on GMO's books that has  
16 not been amortized would almost certainly be required to be paid back to the IRS. In  
17 addition, any amounts imputed could also be in jeopardy of being returned to the IRS.

18 In addition, I concluded that under Treas. Reg. Section 1.46-6(f)(4), once a violation  
19 occurs, it would continue until a final rate order is put into effect curing the violation.  
20 Thus, if a violation occurs at GMO for the imputation of credits, GMO would lose the  
21 opportunity to pursue additional ITCs until the MPSC cured the violation through a  
22 subsequent conforming final rate order.

1 *Arguments Made in Mr. Featherstone's Rebuttal*

2 **Q: What arguments does Mr. Featherstone make to support Staff's recommendations?**

3 A: First, Mr. Featherstone indicates that Staff is not imputing tax credits from KCP&L to  
4 GMO. Staff is not proposing to reduce GMO's tax expense in GMO's rate case filing  
5 (Case No. ER-2012-0175). Second, Mr. Featherstone indicates that the "spirit of the  
6 normalization rules" is not violated by the allocation of a portion of the New ITCs from  
7 KCP&L to GMO. Third, Mr. Featherstone indicates that the ITC normalization rules do  
8 not provide for any "sharing" of benefits between utilities and their customers. Lastly,  
9 Mr. Featherstone contends the reallocation is a prudence issue at heart and not really a  
10 tax issue, and that it would be unfair to not allocate credits between KCP&L and GMO or  
11 develop some other equitable remedy to compensate GMO for not receiving the New  
12 ITCs. He concludes that my Direct Testimony is attempting to "scare" the Commission  
13 in order to let KCP&L "off the hook."

14 *Response to Mr. Featherstone's Rebuttal*

15 **Q: Is it true that the Staff is not imputing tax credits between KCP&L and GMO?**

16 A: At the time my Direct Testimony was prepared, Staff's recommendation was not  
17 available. As discussed above, the import of my Direct Testimony (and Rebuttal  
18 Testimony for that matter) is that any attempt to make GMO economically whole for the  
19 New ITCs that have not been assigned to them by the IRS could be a normalization  
20 violation. The mechanism chosen initially by the Staff to do so is a "reallocation" as  
21 opposed to an "imputation." The difference is mere semantics here and does not change  
22 the fact that the Staff recommendation jeopardizes the creation of a normalization  
23 violation.

1 **Q: Does Mr. Featherstone make a secondary argument around the imputation of**  
2 **credits?**

3 A: Yes, he indicates that Staff "has not included these coal credits as a reduction to GMO's  
4 tax expense in GMO's rate case filing."

5 **Q: Does this cure the normalization concerns?**

6 A: Not really. Presumably, it is Staff's intent to get the New ITCs over to GMO and start  
7 amortizing them consistently with GMO's election under former IRC Section 46(f)(2).  
8 Technically, there is no amortization in cost of service for GMO in this rate case, but  
9 assuming Staff's recommendation were to be carried out, any amortization in future rate  
10 periods would raise normalization concerns consistent with my Direct and Rebuttal  
11 Testimonies. In addition, the other alternative Staff recommendations not directly  
12 involving the reallocation of the credits could also still be considered an indirect  
13 violation.

14 **Q: Does Mr. Featherstone conclude that a normalization violation does not exist here?**

15 A: No. He indicates that the "spirit of the normalization rules" would not be violated  
16 because GMO would be getting its share of the credits commensurate with its respective  
17 plant ownership. That is as close as he comes to actually indicating that there are no  
18 normalization issues here. His analysis ignores the IRS and Department of Treasury  
19 guidance I have provided, and recapped above, that supports that the IRS may indeed find  
20 that a normalization violation exists here.

1 **Q: What about Mr. Featherstone's contention that the ITC normalization rules do not**  
2 **provide for a sharing of tax benefits among utility companies and its customers?**

3 A: This appears to be a difference of opinion between Mr. Featherstone and me. Based on  
4 his Rebuttal Testimony, Mr. Featherstone appears to favor the equity of the depreciation  
5 normalization rules, which allow for cost free use of capital by the utility with a rate base  
6 offset for the deferred taxes created through depreciation. He mentions the ITC  
7 normalization rules as providing a strict choice between giving the ITC benefit over time  
8 through cost of service or allowing the ITC to be a rate base offset but not both.

9 I view the ITC normalization rules as an evolution from pure flow through ratemaking.  
10 As I mention in my Direct Testimony, the ITC normalization rules were enacted to allow  
11 utilities to retain some benefit from ITCs as opposed to flowing the ITCs through  
12 immediately as a reduction to cost of service. The "sharing" aspect to me is that the rules  
13 do not condone the utility amortizing ITC below the line, and they do not allow for  
14 immediate flow through of the benefit to customers. Hence, both the rate base restoration  
15 method of former IRC Section 46(f)(1) and the ratable flow through method of former  
16 IRC Section 46(f)(2) provide different ways for utilities and customers to share the  
17 benefit of the ITCs.

18 **Q: Given that Mr. Featherstone addresses "the spirit" of the normalization rules and**  
19 **provides his opinion as to the ratemaking propriety of the normalization rules, does**  
20 **he provide any other arguments in support of the Staff recommendations?**

21 A: Yes. He concludes his testimony by indicating that the Staff recommendations are more  
22 of a prudency issue as opposed to a tax issue. He runs through a litany of perceived



1 KCP&L abuses, and accuses the Company of hiring me to "scare the Commission" and  
2 "hide behind the IRS on this issue."

3 **Q: Will the IRS consider the "spirit of the normalization rules" and prudence in**  
4 **determining if the Staff's recommendations violate the normalization rules?**

5 A: No. As I indicated in my Rebuttal Testimony, the IRS limits its analysis to the  
6 application of the technical normalization rules and does not address regulatory questions  
7 concerning just and equitable rates. For example, in PLR 9312007, the IRS was asked to  
8 rule on an ITC normalization issue. Before ruling on the issue, the IRS stated the  
9 following:

10 The Service does not determine such purely regulatory questions as  
11 whether the proposals of a public utility commission will produce just and  
12 equitable rates. Consequently, the Service in Taxpayer's first ruling  
13 request will determine only whether the normalization provisions of  
14 section 46(f)(2) of the Code are violated when the investment credit  
15 generated by the disallowed portion of the Plant is transferred to a  
16 nonoperating income account.

17 Note that there is similar language in PLRs 9214033, 9045014 and 9547008. The IRS  
18 has made it clear in multiple instances that it will look to whether the letter of the law has  
19 been violated, and not consider Mr. Featherstone's arguments around prudence and the  
20 spirit of the rules in making its normalization determination.

21 **Q: Are there any arguments outside the IRC and federal regulations interpreting the**  
22 **code that the IRS does consider?**

23 A. Yes. The IRS has indicated in a number of PLRs that it will consider whether the state  
24 commission intends to put the utility into a normalization violation when ruling as to  
25 whether a violation exists. For example, in KCP&L's normalization ruling referenced in  
26 the Rebuttal Testimony of Melissa K. Hardesty, PLR 201230021, the IRS conditions its  
27 ruling that no violation exists if the Commission allows the Company to take corrective

1 action to remediate the violation. A number of other PLRs, including 200933023,  
2 200811004 and 200802025 rule that the main reason a normalization violation was not  
3 found in those cases was because the state commission did not force the utility into the  
4 ratemaking treatment that violated the normalization rules.

5 **Q: So, the IRS will ignore Mr. Featherstone's prudence arguments but would not**  
6 **ignore the Staff's recommendations if they were to force a reallocation or other**  
7 **equitable remedy?**

8 A: Based on the IRS' ruling history, yes. The IRS has repeatedly indicated that it will ignore  
9 equitable ratemaking in determining if a normalization violation exists, but will only find  
10 a violation where a state commission insists on the particular ratemaking treatment that  
11 violates the rules.

12 **Q: Given that Mr. Featherstone does not refute the potential for a normalization**  
13 **violation here and the potential uncertainty around the implications of one, would**  
14 **GPE, KCP&L and GMO be agreeable to requesting a PLR from the IRS on the**  
15 **federal tax implications of what the Staff has proposed?**

16 A: Yes. As indicated in my Rebuttal Testimony and the Rebuttal Testimony of Melissa K.  
17 Hardesty, the Company has drafted a PLR on this issue and is waiting for  
18 acknowledgement from the Staff of the MPSC to send to the IRS.

19 *Conclusion*

20 **Q: Does that conclude your testimony?**

21 A: Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light )  
Company's Request for Authority to Implement ) Case No. ER-2012-0174  
A General Rate Increase for Electric Service )

AFFIDAVIT OF SALVATORE P. MONTALBANO

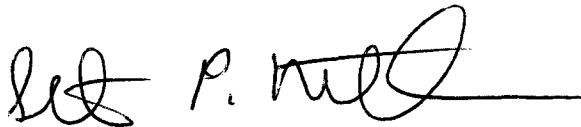
STATE OF MISSOURI )  
) ss  
COUNTY OF JACKSON )

Salvatore P. Montalbano, being first duly sworn on his oath, states:

1. My name is Salvatore P. Montalbano. I am partner with the accounting firm PricewaterhouseCoopers, LLP in Kansas City, Missouri. I have been retained by Great Plains Energy Services, Incorporated, an affiliate of Kansas City Power & Light Company, to serve as an expert witness to provide tax testimony on behalf of Kansas City Power & Light Company.


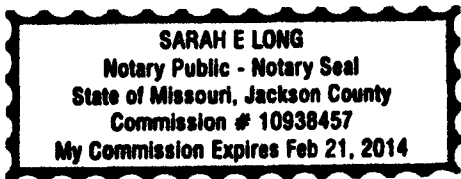
2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony on behalf of Kansas City Power & Light Company consisting of nine (9) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.



Salvatore P. Montalbano

Subscribed and sworn before me this 3rd day of October, 2012.



SARAH E. LONG  
Notary Public

My commission expires: 2-21-2014