

Direct Testimony and Schedules  
John R. Wilde

Before the Minnesota Public Utilities Commission  
State of Minnesota

In the Matter of the Application of Minnesota Energy Resources Corporation for Authority to  
Increase Rates for Natural Gas Service in Minnesota

Docket No. G007,011/GR-10-977

Exhibit \_\_\_\_\_

**Tax Accounting**

November 30, 2010

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1 **I. INTRODUCTION AND QUALIFICATIONS**

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is John R. Wilde. My business address is Integrys Energy Group, Inc.  
4 (“Integrys”), 700 North Adams Street, P.O. Box 19001, Green Bay, WI 54307-9001.

5  
6 Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

7 A. I am an Assistant Vice President, and am responsible for various tax issues of Integrys  
8 Business Support, LLC (“IBS”). Both Minnesota Energy Resources Corporation  
9 (“MERC”) and IBS are wholly-owned subsidiaries of Integrys.

10  
11 Q. PLEASE SUMMARIZE YOUR QUALIFICATIONS AND EXPERIENCE.

12 A. I graduated from Saint Norbert College, DePere, Wisconsin in 1984 with a Bachelor of  
13 Business Administration degree in Accounting. I have a graduate certificate in state and  
14 local taxation, as well as a Masters Degree in Taxation, from the University of  
15 Wisconsin-Milwaukee. I have been employed by Integrys or its predecessors since 1984,  
16 and since 1986 I have been employed in the Corporate Tax Department.

17  
18 Q. FOR WHOM ARE YOU PROVIDING TESTIMONY?

19 A. I am providing testimony on behalf of MERC.

20  
21 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

22 A. I am presenting and supporting the change in tax methods of accounting that MERC has  
23 proposed to the Internal Revenue Service (“IRS”) for 2009 related to the capitalization of

1 repairs and overheads. If allowed these changes will be applicable for MERC's state and  
2 federal income tax filings beginning in 2009.

3  
4 Also, I present and support MERC's regulatory accounting treatment of the re-  
5 measurement of deferred tax balances related to post retirement medical obligations  
6 caused by recent changes in tax law, namely the Patient Protection and Affordable Care  
7 Act ("PPACA"), and the Health Care and Education Affordability Reconciliation Act of  
8 2010 ("HCEARA"). These acts were signed into law on March 23, 2010 and March 30,  
9 2010, respectively.

10  
11 Q. ARE YOU SPONSORING ANY EXHIBITS IN CONNECTION WITH YOUR  
12 TESTIMONY IN THIS PROCEEDING?

13 A. No, I am not.

14

1 **II. CAPITALIZATION OF REPAIRS AND OVERHEADS**

2 Q. PLEASE DESCRIBE THE CHANGE IN THE CAPITALIZATION OF REPAIRS FOR  
3 TAX PURPOSES.

4 A. Conceptually, the change in the capitalization of repairs for tax purposes is to align the  
5 determination of what is a repair or maintenance activity versus a capital expenditure  
6 based on what is allowed for tax purposes as opposed to our historic practice, which  
7 generally followed the determination made for financial and regulatory accounting  
8 purposes. As a result, certain expenditures that previously would have been considered  
9 “capitalized for tax purposes” will now be defined as “operations and maintenance  
10 expense for tax purposes.” This will result in a current year tax deduction to adjust the  
11 tax basis for the cumulative effect of this change in the tax method of accounting.

12  
13 At the same time, determinations of repair and maintenance versus capital will not  
14 change for regulatory and financial accounting purposes. This will result in book-to-tax  
15 difference (\$3.1 million reflected in this filing) that will result in an increased deferred  
16 tax liability (\$1.2 million reflected in this filing) associated with plant in service. This  
17 increased deferred tax liability will decrease MERC’s rate base, and lower MERC’s  
18 revenue requirement.

19  
20 Q. PLEASE DESCRIBE THE CHANGE IN THE CAPITALIZATION OF THE  
21 OVERHEADS FOR TAX PURPOSES.

22 A. Conceptually, the change in the capitalization of overheads for tax purposes redefines  
23 what overheads will be allocated to plant and capitalized for tax purposes, and what

1 overheads will be allocated to production costs or expensed for tax purposes. As a result,  
2 certain overheads that previously would have been considered “capitalized to plant for  
3 tax purposes” will now be defined as “operations and maintenance expense”, or  
4 “production costs for tax purposes.” This will result in an increased current year tax  
5 deduction to adjust the tax basis for the cumulative effect of this change in the tax method  
6 of accounting.

7  
8 At the same time, the definition of what overheads will be allocated and capitalized to  
9 plant will not change for regulatory and financial accounting purposes. This will result in  
10 a book-to-tax difference (\$2.2 million reflected in this filing) that will result in an  
11 increased deferred tax liability (\$0.9 million reflected in this filing) associated with plant  
12 in service. This increased deferred tax liability will decrease MERC’s rate base, and  
13 lower MERC’s revenue requirement.

14  
15 Q. WILL THESE CHANGES BENEFIT MERC’S CUSTOMERS?

16 A. Yes, they will, because the changes will increase the balance of MERC’s deferred income  
17 tax liability associated with plant in service. This increased deferred tax liability will  
18 decrease MERC’s rate base, and lower MERC’s revenue requirement.

19  
20 Q. DO THESE CHANGES REQUIRE APPROVAL FROM THE IRS?

21 A. These changes will be implemented with the consent of the IRS, however, they will also  
22 be subject to modification upon examination by the IRS and other taxing authorities.

1 Deloitte & Touche will be assisting MERC in the execution of these changes, and to  
2 support the resulting proposed tax deductions.

3

4 Q. HAVE THE CHANGES DESCRIBED ABOVE BEEN INCORPORATED IN MERC'S  
5 INSTANT RATE CASE FILING FOR THE 2011 TEST YEAR?

6 A. Yes, they have.

7

8 Q. HAVE THE TAX CHANGES DESCRIBED ABOVE BEEN IMPLEMENTED AT  
9 OTHER INTEGRY'S REGULATED UTILITIES, AND REFLECTED IN ANY OF  
10 THEIR GENERAL RATE CASES?

11 A. Yes, they have, as these tax changes are part of a corporate wide initiative that was  
12 implemented at all of Integry's regulated utilities. Currently the only other Integry's  
13 utilities to include these changes in a general rate case has been Wisconsin Public Service  
14 Corporation ("WPSC") and Upper Peninsula Power Company ("UPPCO"), as WPSC and  
15 UPPCO are the only other Integry's regulated utilities to file a general rate case since the  
16 implementation of these tax changes.

17

1 **III. HEALTH CARE REFORM LEGISLATION**

2 Q. PLEASE DESCRIBE THE RE-MEASUREMENT OF DEFERRED TAX BALANCES  
3 CAUSED BY ENACTMENT OF FEDERAL HEALTH CARE REFORM  
4 LEGISLATION IN 2010.

5 A. The PPACA, enacted in 2010, requires the amount of the Retiree Drug Subsidy (“RDS”)  
6 received after December 31, 2012 to be offset against the employer's deduction for health  
7 care expenses, thus reducing the associated tax deduction the employer was previously  
8 allowed for post-2012 health care expense. That is, the change in tax treatment does not  
9 affect the taxation of the RDS itself, but reduces the employer's tax deduction for the cost  
10 of health care for retirees by the amount of the RDS received.

11  
12 As a result of the PPACA, in 2010, MERC must reflect in its deferred tax accounting that  
13 portion of MERC’s expected future actual health care expenditures that will not be  
14 deductible as a result of the PPACA. Therefore, the non-deductible portion of MERC’s  
15 future health care expenditures will be measured based on the amount of the RDS that  
16 MERC expects to receive after 2012.

17  
18 Q. PLEASE DESCRIBE MERC’S PROPOSED REGULATORY ACCOUNTING FOR  
19 THE RE-MEASUREMENT OF DEFERRED TAX BALANCES CAUSED BY  
20 ENACTMENT OF HEALTH CARE REFORM LEGISLATION IN 2010.

21 A. MERC proposes to account for this change in tax law, and the resulting effects on its  
22 deferred tax balances, following the principles of full normalization and using the  
23 average rate assumption method (“ARAM”), effective with the enactment date of 2010

1 federal health care legislation. Applying the principles of full normalization and using  
2 ARAM would result in the re-measurement of deferred taxes for the change in tax law  
3 being offset by a regulatory deferral. Both the resulting deferred tax balance and the  
4 offsetting regulatory deferral would be normalized through the provision for income  
5 taxes used to determine MERC's rates starting in 2013, when the new law takes effect,  
6 and continuing over the time period that the accrued benefit expenses for post retirement  
7 prescription drug charges are actually incurred.

8  
9 Q. DOES MERC REQUEST COMMISSION APPROVAL OF MERC'S PROPOSED  
10 REGULATORY ACCOUNTING FOR THE RE-MEASUREMENT OF DEFERRED  
11 TAX BALANCES CAUSED BY ENACTMENT OF HEALTH CARE REFORM  
12 LEGISLATION IN 2010, AS DESCRIBED ABOVE?

13 A. Yes, we do. Based on MERC's review of Securities and Exchange Commission  
14 documents filed by other Minnesota utilities or their parent corporations, MERC  
15 understands this is an accepted practice in Minnesota, and it is consistent with the past  
16 practice of other Integrys utilities. Further, this proposal will benefit MERC's customers,  
17 as it reduces MERC's costs in the 2011 proposed test year. The alternative would be for  
18 MERC to "flow-through" these costs and recognize any benefits in 2010, which would  
19 solely benefit MERC's shareholder.

20

**IV. CONCLUSION**

1

2 Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

3 A. Yes, it does.