

BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

**IN THE MATTER OF THE APPLICATION)
OF PUBLIC SERVICE COMPANY OF NEW)
MEXICO FOR REVISION OF ITS RETAIL)
ELECTRIC RATES PURSUANT TO ADVICE)
NOTICE NO. 595)**

Case No. 22-00270-UT

**PUBLIC SERVICE COMPANY OF NEW)
MEXICO,)**

Applicant)

_____)

DIRECT TESTIMONY

OF

ALAN D. FELSENTHAL

December 5, 2022

**NMPRC CASE NO. 22-00270-UT
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ALAN D. FELSENTHAL**

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1

I. INTRODUCTION AND PURPOSE

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, OCCUPATION AND**
3 **EMPLOYER.**

4 **A.** My name is Alan Felsenthal. My business address is One North Wacker Drive, Chicago,
5 Illinois, 60606. I am a Managing Director at PricewaterhouseCoopers LLP (“PwC”).

6

7 **Q. ON WHOSE BEHALF ARE YOU SUBMITTING THIS TESTIMONY?¹**

8 **A.** I am submitting this testimony on behalf of Public Service Company of New Mexico
9 (“PNM”, or the “Company”).

10

11 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

12 **A.** My testimony:

- 13 • Discusses the accounting and related ratemaking principles for income taxes for public
14 utilities like PNM;
- 15 • Describes the changes caused by the Tax Cuts and Jobs Act of 2017 (“TCJA”) and the
16 general impact of those changes on regulated utilities;
- 17 • Explains the ratemaking treatment proposed by the Company for “protected”
18 deficient/excess accumulated deferred income taxes (“excess ADIT”) and how such
19 treatment complies with the TCJA requirement for such excess; and

¹ This direct testimony was prepared in connection with the current Public Service Company of New Mexico rate case and for the use and benefit of Public Service Company of New Mexico. PwC disclaims any contractual or other responsibility to others based on their access to or use of this direct testimony and the information contained herein.

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- 1 • Explains the ratemaking treatment proposed by the Company for “unprotected” excess
2 ADIT.

3
4 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND BUSINESS**
5 **EXPERIENCE.**

6 **A.** I graduated from the University of Illinois in 1971 and began my career at Arthur Andersen
7 & Co (“Arthur Andersen”), where I was an auditor, and focused on audits of financial
8 statements of regulated entities. In 2002, I joined PwC and became a Managing Director
9 in their Power and Utilities Group and continued performing audits for regulated entities.
10 I was hired by Huron Consulting Group (“Huron”) in 2008 and returned to PwC in
11 November of 2010. At both Arthur Andersen and PwC, I supervised audits of financial
12 statements on which the firms issued audit opinions that were filed with the SEC, the
13 Federal Communications Commission, the Federal Energy Regulatory Commission
14 (“FERC”) and various state commissions. At Arthur Andersen, PwC and Huron, I
15 consulted on a significant number of utility rate cases and helped develop testimony for
16 myself and others on a variety of issues, including construction work in progress in rate
17 base, projected test years, lead-lag studies, cost allocation, several accounting issues (e.g.,
18 pension accounting, regulatory accounting, income tax accounting, cost of removal) and
19 compliance with the income tax normalization requirements.

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1 **Q. PLEASE DESCRIBE YOUR DUTIES AND RESPONSIBILITIES AT PWC.**

2 **A.** I am currently a member of PwC’s Complex Accounting and Regulatory Solutions
3 (“CARS”) practice. Throughout my career, my focus has been on the regulated industry
4 sector, primarily electric, gas, telecommunication and water utilities. I have focused on
5 utility accounting, income tax and regulatory issues, primarily as a result of auditing
6 regulated enterprises. The unique accounting standards applicable to regulated entities
7 embodied in Accounting Standards Codification (“ASC”) 980, Regulated Operations
8 (formerly, Statement of Financial Accounting Standards) (“SFAS”) 71, FAS 90, FAS 92,
9 FAS 101 and various Emerging Issues Task Force (“EITF”) issues, all need to be
10 understood so that auditors can determine whether a company’s financial statements are
11 fairly presented in accordance with generally accepted accounting principles (“GAAP”). I
12 have witnessed the issuance of these standards and have consulted with utilities as to how
13 they should be applied. At both Arthur Andersen and PwC, I worked with the technical
14 industry accounting and auditing leadership to communicate and consult on utility
15 accounting and audit matters. My curriculum vitae is attached as PNM Exhibit ADF-1.

16

17 **Q. HAVE YOU PREVIOUSLY TESTIFIED OR SUBMITTED TESTIMONY BEFORE**
18 **THE NEW MEXICO PUBLIC REGULATION COMMISSION (“COMMISSION”)**
19 **OR ANY OTHER REGULATORY COMMISSION?**

20 **A.** Yes. While I have not testified in New Mexico, I have testified before numerous other state
21 public utility commissions and the Federal Energy Regulatory Commission (“FERC”). My

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1 Curriculum Vitae, PNM Exhibit ADF-1, lists the various issues and testimony I have
2 presented as well as the jurisdiction.

3

4 **Q. HAVE YOU PROVIDED TRAINING ON THE APPLICATION OF GAAP TO**
5 **REGULATED ENTERPRISES?**

6 **A.** Yes. At Arthur Andersen, Huron and PwC, I developed and instructed utility accounting
7 seminars focusing on the unique aspects of the regulatory process and the resulting
8 accounting consequences of the application of GAAP. I have presented seminars, as well
9 as delivered training on an in-house basis. Seminar participants have included utility
10 company and regulatory commission staff accountants, utility rate departments and internal
11 auditors, tax accountants and others. I have also conducted these seminars for FERC and
12 several state commissions, and I have presented at various Edison Electric Institute and
13 American Gas Association ratemaking and accounting seminars. The income tax training
14 programs I have presented include topics such as the normalization requirements for public
15 utilities in the Internal Revenue Code (“IRC”), protected and unprotected deferred taxes and
16 the mechanics and application of the Average Rate Assumption Method (“ARAM”).

17

18 **Q. WHY IS THE TREATMENT OF EXCESS ADIT IMPORTANT TO PNM’S**
19 **APPLICATION?**

20 **A.** As I will explain below, the IRC contains certain requirements with respect to the reversal
21 of certain excess ADIT (the ADIT related to protected book-tax differences) that must be
22 followed in utility rate cases in order to comply with the normalization provisions of the

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1 IRC. Failure to comply with these normalization provisions would preclude PNM from
2 claiming accelerated depreciation on its tax returns, affecting current income taxes payable
3 and increasing the rate base by excluding ADIT Liabilities, thereby losing a significant
4 customer benefit. In addition, for excess ADIT not subject to the IRC rules, my testimony
5 addresses the method PNM is using to reverse the unprotected excess ADIT, which results
6 in a faster return of this benefit to customers.

7

8 **II. INCOME TAX ACCOUNTING AND RATEMAKING FUNDAMENTALS**

9

10 **Q. CAN YOU PLEASE DESCRIBE THE ACCOUNTING FOR INCOME TAXES**
11 **REQUIRED UNDER GAAP.**

12 **A.** Yes. Accounting for income taxes under GAAP is addressed in the accounting literature in
13 section ASC 740 (formerly SFAS No. 109, Accounting for Income Taxes (SFAS 109)) of
14 the accounting codification (“ASC 740”).

15

16 **Q. WHAT ARE THE COMPONENTS OF DETERMINING INCOME TAX EXPENSE**
17 **FOR RATEMAKING?**

18 **A.** The components to the calculation of income tax expense for purposes of determining rates
19 are: current income taxes; deferred income taxes; and investment tax credit. The investment
20 tax credit is not an issue in this proceeding.

21

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1 **Q. PLEASE DESCRIBE THE FIRST COMPONENT OF DETERMINING THE**
2 **TOTAL INCOME TAX EXPENSE, WHICH IS CURRENT INCOME TAX**
3 **EXPENSE.**

4 **A.** Current income tax expense represents the estimated amount of current year income taxes
5 based on current year taxable income, determined in accordance with the IRC. For purposes
6 of preparing an income tax return each year, the IRC contains procedures for determining
7 if and when an item is “taxable” or “deductible.”

8

9 It should be noted that the IRC rules for determining what is taxable or deductible may differ
10 from what is reportable as “revenue,” “income” or “expense” under GAAP. Deferred
11 income taxes are recorded for most differences between the IRC and GAAP treatment of
12 revenue, income and expense.

13

14 **Q. WHAT ARE INCOME TAX TIMING/TEMPORARY DIFFERENCES AND HOW**
15 **DO THEY THOSE DIFFERENCES AFFECT TAXABLE INCOME?**

16 **A.** A timing difference refers to a difference between the periods in which transactions affect
17 taxable income shown on the income tax return (based on the IRC rules) and the periods in
18 which such transactions enter into the determination of pre-tax accounting income (based
19 on GAAP) as reported in the financial statements. A timing difference originates in one
20 period and reverses or “turns around” in one or more subsequent periods. Some differences
21 reduce income tax that would otherwise be payable currently; others increase income taxes
22 that would otherwise be payable currently. Timing differences are an income statement

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1 concept as they can be determined by comparing items on a given period's income statement
2 to the tax return for the same period.

3

4 Temporary differences are a balance sheet concept representing the differences between the
5 tax bases of assets/liabilities and the book bases of such assets/liabilities. Some temporary
6 differences result in ADIT Liabilities and other temporary differences result in ADIT
7 Assets. Timing differences originating/reversing during a period impact temporary
8 differences at the end of the period.

9

10 **Q. ARE ALL DIFFERENCES BETWEEN THE BOOK TREATMENT OF REVENUE,**
11 **INCOME OR EXPENSES AND THE TREATMENT OF SUCH ITEMS FOR**
12 **INCOME TAX RETURN PURPOSES TEMPORARY OR TIMING?**

13 **A.** No. While the vast majority of book-tax differences are of a temporary or timing nature,
14 there are some differences that only enter into the determination of book income and will
15 not enter into the determination of taxable income on a company's income tax return. These
16 are referred to as permanent differences. An example of a permanent difference is a life
17 insurance premium paid by the company on behalf of an officer. For book purposes that
18 insurance premium is an operating expense, but that same insurance premium is not
19 deductible when determining the amount of income taxes due to the U.S. Treasury.

20

21 **Q. PLEASE DESCRIBE THE SECOND COMPONENT OF DETERMINING INCOME**
22 **TAX EXPENSE, WHICH IS DEFERRED INCOME TAX EXPENSE.**

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1 **A.** Deferred income tax expense represents the income tax consequences of timing/temporary
2 differences, which as I stated, are transactions occurring in the current period but, under the
3 IRC rules, not included in the current year tax return and thus, not payable currently.
4 However, such incurred amounts are expected to be paid in future periods and, therefore,
5 under accrual accounting, are accrued as a deferred income tax. For example, the IRC
6 permits the use of accelerated depreciation when computing each period’s taxable income
7 and current tax payment. The tax deduction for accelerated depreciation is contrasted with
8 what occurs on the books where companies typically depreciate property, plant and
9 equipment on a straight-line basis over the estimated useful life of utility property, plant and
10 equipment (“PPE”). While in each year the PPE itself is subject to the separate calculation
11 of book depreciation (using a straight-line methodology where amounts are consistent from
12 year-to-year) and tax return depreciation (using an accelerated methodology permitted
13 under the IRC where typically tax return depreciation deductions are greater in the early
14 years and decline over the PPE’s tax life), over the entire book and tax life, both calculations
15 are limited to the cost of the fixed asset itself. So, when tax depreciation exceeds book
16 depreciation in the early years, at some point the situation will reverse and book depreciation
17 will exceed tax depreciation. This is an example of a timing difference—over time the
18 cumulative amount of tax depreciation will equal the cumulative amount of book
19 depreciation. Therefore, in the early years when accelerated tax depreciation is deducted in
20 arriving at taxable income on the tax return, the resulting current income tax is reduced.
21 However, this situation will reverse in the future as accelerated tax depreciation deductions
22 are reduced or run out and, in such situations, taxable income and current taxes will increase.

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1 The ADIT recorded when the timing/temporary difference arise, are available to cover the
2 future higher income tax payments upon reversal.

3

4 On the other hand, deferred income taxes are not required or recorded on permanent book-
5 tax differences. Permanent differences do not reverse over time. Permanent differences
6 typically impact only the current income tax expense calculation. Unlike a
7 timing/temporary difference that impacts both the current tax expense when that difference
8 originates and current income tax expense when that difference reverses (establishing the
9 need for ADIT upon origination), permanent differences will not result in a future impact
10 and, therefore deferred income taxes and ADIT are not recorded.

11

12 **Q. ARE CURRENT AND DEFERRED INCOME TAX COMPONENTS**
13 **CALCULATED INDEPENDENTLY OF ONE ANOTHER?**

14 **A.** They are calculated independently but the two components are linked in that the
15 timing/temporary differences that impact current income tax expense are the same
16 timing/temporary differences impacting deferred income tax expense. When a
17 timing/temporary difference reduces current income tax expense when that
18 timing/temporary difference originates, that same timing/temporary difference increases
19 deferred income tax expense. At the point in time that the timing difference reverses,
20 deferred income tax expense is reduced and current income tax expense is increased. The
21 result is TOTAL income tax expense (the sum of the current and deferred components),

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1 which relates to/matches the pre-tax revenues, income and expenses recorded for the
2 reporting period under GAAP.

3
4 Under GAAP, because the financial statements reflect accrual, not cash basis accounting,
5 deferred income taxes are recorded on timing/temporary differences. As a result, income
6 tax expense under GAAP includes both a current income tax expense component (as
7 previously described, based on the tax return), as well as a “deferred” income tax component
8 (accrued, based on timing/temporary differences). Such deferred income taxes reflect the
9 liability or asset for income taxes payable or receivable in the future stemming from
10 transactions recorded in the financial statements currently. In other words, to the extent that
11 accelerated tax depreciation is claimed on the income tax return in an amount that exceeds
12 book depreciation reported on the financial statements, a liability for future taxes results.
13 This future tax liability is caused by greater tax depreciation claimed in early years that “use
14 up” the tax basis of assets and when such future tax depreciation is less than future book
15 depreciation, higher taxes in the future result.

16
17 From a journal entry perspective, as current tax expense is recorded (typically a debit), the
18 other side of the entry (credit) is income taxes payable currently on the balance sheet. When
19 deferred income tax expense is recorded (debit) the other side of the entry (credit) is
20 reflected on the balance sheet as “ADIT.” It is also possible for certain timing differences
21 to result in a current income tax credit and an ADIT debit.

22

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1 **Q. HAS THE ACCOUNTING FOR INCOME TAXES UNDER GAAP BEEN**
2 **ADOPTED BY FERC’S UNIFORM SYSTEM OF ACCOUNTS (“USOA”)?**

3 **A.** Yes. Most rate-regulated entities maintain their books and records in accordance with the
4 FERC USoA. The FERC has embraced deferred income tax accounting and the USoA
5 contains the following income tax accounts for current and deferred income taxes:

6 ***Income Statement Accounts – Current***

7 409.1 Income Taxes, Utility Operating Income

8 409.2 Income Taxes, Other Income and Deductions

9 409.3 Income Taxes, Extraordinary Items

11 ***Income Statement Accounts – Deferred***

12 410.1 Provision for Deferred Income Taxes, Utility Operating Income

13 410.2 Provision for Deferred Income Taxes, Other Income and Deductions

14 411.1 Provision for Deferred Income Taxes-Credit, Utility Operating Income

15 411.2 Provision for Deferred Income Taxes-Credit, Other Income and Deductions

17 ***Balance Sheet Accounts – Current***

18 236 Taxes Accrued

20 ***Balance Sheet Accounts – Deferred***

21 190 Accumulated Deferred Income Taxes

22 281 Accumulated Deferred Income Taxes-Accelerated Amortization Property

23 282 Accumulated Deferred Income Taxes-Other Property

24 283 Accumulated Deferred Income Taxes-Other

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1 Note that the FERC USoA contains multiple balance sheet accounts for ADIT. To
2 determine a company's net deferred tax liability or deferred tax asset, all ADIT balance
3 sheet accounts must be aggregated.

4

5 **Q. HOW SHOULD FEDERAL AND STATE INCOME TAX EXPENSE FOR**
6 **RATEMAKING PURPOSES BE DETERMINED?**

7 **A.** Income taxes should be determined in accordance with GAAP as provided in ASC 740,
8 which requires interperiod income tax allocation, also referred to as "recording deferred
9 income taxes" or "normalization." Normalization, which is considered by most accountants
10 to be theoretically correct, is the accrual accounting / ratemaking practice that distributes
11 income tax expense to time periods and, therefore, to customers' revenue requirements
12 consistently with the costs (such as depreciation) that are affecting pre-tax cost of service.
13 As the ratemaking process necessarily involves the deferral of costs such as plant
14 investment and the distribution of these costs over time, normalization is used to produce
15 a consistent determination of income tax expense.

16

17 In addition to GAAP, the Securities and Exchange Commission also requires ASC 740 to
18 be followed as the income tax standard that must be used by all U. S. companies.

19

20 **Q. IS NORMALIZATION SOUND FROM THE VIEWPOINT OF DETERMINING**
21 **COSTS FOR RATEMAKING?**

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1 **A.** Yes. Unlike other expenses, income tax expense has no independent existence. A correct
2 allowance cannot be determined merely by reference to current income tax amounts paid.
3 This is true because each component of revenue, income and expenses, determined on an
4 accrual accounting basis, has a related income tax impact, which also should be determined
5 on an accrual, not cash, basis. The total income tax expense (total of current and deferred
6 income tax expense) is thus a simple arithmetic function of the non-income tax components
7 of the revenue requirements including return, which are appropriate for setting rates.

8

9 The very essence of determining costs for ratemaking purposes is resolving the question of
10 the amount of costs to be recognized as current-period costs, those which are to be
11 “deferred” and those which should not be included in cost of service.

12

13 Having determined which costs are to be recognized currently, which are to be deferred,
14 and which should not be allowed in the ratemaking process, the related income tax must be
15 handled consistently (“matched”) or the initial cost determination is effectively
16 countermanded to that extent. In other words, if a cost is not permitted to be recovered in
17 the ratemaking process such as a loss on abandonment of an asset, the income tax impact of
18 such loss is not included in determining rate case income tax expense even though there
19 may be an allowable tax return deduction for such loss. It would be unfair and inequitable
20 to not permit the recovery of a cost in the ratemaking process but to permit the related
21 income tax benefit to reduce ratemaking income tax expense.

22

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1 **Q. WILL YOU PLEASE ILLUSTRATE HOW THE CUSTOMER CURRENTLY**
2 **RECEIVES A BENEFIT BY WAY OF A REDUCTION IN REVENUE**
3 **REQUIREMENTS, WHICH IS EQUAL TO THE INCREASE IN REVENUE**
4 **REQUIREMENTS CAUSED BY THE ALLOWANCE OF A PROVISION FOR**
5 **DEFERRED TAXES.**

6 **A.** Yes. Both current income tax expense and the provision for deferred income taxes have an
7 income tax effect in determining rates to customers. The following example depicts the
8 components of income tax expense for ratemaking purposes under the normalization
9 method.

10

11 This example assumes a \$15,000 property item with a three-year book life, no salvage, a
12 21% Federal income tax rate and the use of 100% bonus depreciation available for tax return
13 purposes. (For purposes of simplicity, the important effects of reducing the revenue
14 requirement by virtue of deducting the reserve for deferred income taxes from rate base is
15 excluded.) The Year 1 income tax calculation would include the depreciation-related
16 income tax impacts as follows:

17

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	Year 1		
	Books	Tax Return	Difference
Depreciation	\$5,000	\$15,000	\$10,000
Tax Rate	21%	21%	21%
Current Income Tax (a)	(\$3,150)	↔ (\$3,150)	
Deferred Income Tax (b)	<u>\$2,100</u>	↔	\$2,100
Total Tax (a) +(b)=(c) OR	(\$1,050)		(\$1,050)
Pre-Tax Book Income x Tax Rate			

1

2

3

4

5

6

7

8

9

10

11 **Q. HOW DOES INCREASING/DECREASING INCOME TAX EXPENSE IMPACT**
12 **REVENUE REQUIREMENTS?**

13 **A.** Because income tax expense is not deductible for income tax purposes, the revenues
14 necessary to recover income tax expense needs to be grossed-up, as each additional dollar

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1 of revenue will increase income taxes by \$0.21 (unlike other expenses, which are deductible
2 for income tax purposes and result in a dollar-for-dollar impact on revenue requirements).
3 The gross-up formula is to multiply the recoverable income tax expense by $1 + (\text{tax rate}/(1 -$
4 $\text{tax rate}))$. At a 21% income tax rate, the gross-up factor is 1.2658 ($1 + (.21/.79)$). The
5 reduction in current income tax expense due to accelerated depreciation results in a revenue
6 requirement **reduction** of \$2,658 ($\$2,100 \text{ lower tax expense} \times (1 + .21/.79)$). However, to
7 recognize the tax deferral for the \$10,000 timing difference, a provision of \$2,100 for
8 deferred income taxes is made. This provision has effect of **increasing** revenue
9 requirements by \$2,658 ($\$2,100 \text{ times } (1 + (.21/.79))$), with the increase in revenue
10 requirements being equal to the current reduction. Therefore, as the customer has
11 experienced a \$2,658 benefit and a \$2,658 detriment, the net effect on them is zero, before
12 considering the substantial benefit of deducting the reserve from rate base. While my
13 example, for sake of simplicity, relates to a single unit of property, the effect for multiple
14 units with various in-service dates, service lives, etc., such as is the case for PNM, is merely
15 a summation of these effects for all property units.

16

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1 **Q. WHAT HAPPENS IN YEARS 2 AND 3 IN YOUR EXAMPLE?**

2 **A. In both** Years 2 and 3, the income tax accounting would be as follows:

	Year 2 and Year 3		
	Books	Tax Return	Difference
Depreciation	\$5,000	\$ 0	\$(5,000)
Tax Rate	21%	21%	21%
Current Income Tax (a)	\$ 0	\$0	
Deferred Income Tax (b)	(<u>\$ 1,050</u>)		(<u>\$1,050</u>)
Total Tax (a) +(b)=(c) OR	(\$1,050)		
Pre-Tax Book Income x Tax Rate			

3

4 In each of Years 2 and 3, the book-tax difference reverses. On the books, \$5,000 of straight-
 5 line depreciation is recorded (\$15,000 PPE addition in Year 1 over the estimated three-year
 6 book life), while for income tax return purposes there is no tax depreciation available in
 7 these years as the entire basis was claimed as bonus depreciation in Year 1. Current income
 8 taxes are increased by \$1,050 each year (instead of a negative current income tax due to
 9 claiming tax depreciation, there is no such remaining deduction for this asset), resulting in
 10 additional revenue requirements of \$1,329 (\$1,050 grossed up), while the same amount of
 11 deferred income taxes reverse.

12

13 Over the three-year period in this example, cost of service has included the leveled
 14 “normal” income total income tax expense of \$1,050 each year—based on straight-line

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1 depreciation book and ratemaking treatment. As I have stated, a normalized income tax
2 expense is based on pre-tax book income (determined on an accrual basis) matching the
3 income tax impact of transactions with the revenues, income and expenses themselves.

4

5 While the total income tax expense impact to customers is zero, the ADIT balance reduces
6 rate base, providing a customer benefit reflecting the zero-cost nature of the ADIT source
7 of funds.

8

9 **Q. WHILE YOUR EXAMPLE AND DISCUSSION SO FAR HAVE TALKED ABOUT**
10 **ACCELERATED DEPRECIATION, HOW ARE OTHER TIMING/TEMPORARY**
11 **DIFFERENCES TREATED?**

12 **A.** I have concentrated on accelerated depreciation only because it is a more understood item
13 and, therefore, easier to talk about. All timing/temporary differences that arise from
14 different treatment for books versus IRC purposes should be handled consistently and
15 normalization is the only appropriate method.

16

17 **Q. UNDER NORMALIZATION, WHAT IS THE SOURCE OF THE RESULTING**
18 **ADIT?**

19 **A.** The deferred tax funds come from the U.S. Treasury. They are effectively loans from the
20 U.S. Treasury at zero interest cost, and they have a zero cost to the customers but produce
21 substantial benefits to them. This is true because, under the normalization method, the

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1 customers effectively receive a benefit (a reduction in current income tax expense), which
2 is equal to the provision for deferred taxes.

3

4 **Q. YOU STATED THAT DEFERRED INCOME TAXES ARE OFTEN REFERRED TO**
5 **AS AN INTEREST FREE LOAN FROM THE U.S. TREASURY. HAS THE U.S.**
6 **TREASURY, THROUGH THE IRC, PRESCRIBED HOW DEFERRED INCOME**
7 **TAXES ARE TO BE TREATED IN THE RATEMAKING PROCESS?**

8 **A.** Yes. The IRC contains guidance on how deferred income taxes are to be treated in the
9 ratemaking process and that guidance is referred to as the IRC normalization rules. Such
10 rules are necessary to assure public utilities and their customers are afforded the full benefit
11 of the interest-free loan Congress intended when it enacted accelerated depreciation in the
12 IRC. Congress believed that allowing companies to increase their tax depreciation
13 deductions (and thereby reduce current income tax payments) would lower the financing
14 costs of their investment in capital assets more quickly and thus they would be incented to
15 make additional investments.

16

17 To ensure that rate-regulated utilities receive the benefits intended by Congress, there are
18 separate rules applicable to book-tax method and life differences (“protected differences”)
19 that govern how deferred income taxes are to be treated in determining revenue
20 requirements. The IRC normalization rules require that deferred income tax expense on
21 such book-tax differences be permitted as a recoverable expense with the related ADIT

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1 reducing rate base. If these normalization rules are not followed, the Company is prohibited
2 from claiming accelerated depreciation. It is a significant penalty.

3
4 Because the ADIT balance reduces rate base, the customer actually benefits from this
5 procedure, as the U.S. Treasury is providing funds that, in the absence of accelerated tax
6 deductions and deferred tax accounting, would need to be obtained from other sources, such
7 as debt and equity, which have a cost (interest or return).²

8

9 **Q. ARE ALL BOOK-TAX TIMING/TEMPORARY DIFFERENCES “PROTECTED”**
10 **BY THE IRC?**

11 **A. No.** The book-tax depreciation differences protected by the IRC include:

- 12 • Differences due to the use of accelerated depreciation for tax return purposes versus
13 straight-line depreciation used for books;
- 14 • Differences in lives used to determine tax versus book depreciation;
- 15 • Differences on protected book-tax differences due to tax rate changes;

² Section 168(i)(9)(A)(i) of the IRC requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under § 168(i)(9)(A)(ii), if the amount allowable as a deduction under § 168 differs from the amount that would be allowable as a deduction under § 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under § 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the IRC provides that one way the requirements of § 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under § 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer’s tax expense, depreciation expense, or reserve for deferred taxes under § 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.

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- 1 • Net Operating Losses (“NOLs”) caused by the use of accelerated depreciation; and
2 • Differences relating to Contributions in Aid of Construction as well as the
3 Investment Tax Credit.

4 All other book-tax differences are unprotected, which means they are not
5 covered/protected by the normalization provisions of the IRC.

6

7 **Q. FROM A RATEMAKING PERSPECTIVE, IS THERE A WAY TO COMPUTE OR**
8 **CHECK THAT THE APPROPRIATE INCOME TAXES HAVE BEEN**
9 **CONSIDERED IN DETERMINING THE REVENUE REQUIREMENT?**

10 **A.** Yes. Federal income taxes (total income taxes, the sum of current tax expense and deferred
11 tax expense) requested by the Company and included in the revenue requirement
12 determination should be based on the calculated equity return (rate base times weighted cost
13 of equity) adjusted for permanent differences as determined in the rate case.

14

15 **Q. HAS THE FERC TAKEN A POSITION ON THE APPROPRIATENESS OF**
16 **DEFERRED INCOME TAX ACCOUNTING?**

17 **A.** Yes. The FERC requires comprehensive inter-period income tax allocation for all book-tax
18 timing/temporary differences. Orders 144 and 144A provide guidance in this area. This
19 has been the FERC methodology since the early 1980s. As I previously described, the
20 FERC USoA contains accounts for the current and deferred income tax components and
21 many FERC rate orders require normalization.

22

23

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1 **Q. DOES THE PREVIOUS DISTINCTION YOU DESCRIBED BETWEEN**
2 **PROTECTED AND UNPROTECTED ADIT MATTER UNDER THE TCJA?**

3 **A.** Yes. As I will describe in the next section of my testimony, among other things, the TCJA
4 reduced the corporate income tax rate resulting in deficient or excess ADIT. The distinction
5 between protected ADIT and unprotected ADIT is critical. The TCJA contains specific
6 language on how excess ADIT relating to protected ADIT is to be treated in order to avoid
7 a normalization violation. Similar guidance does not exist for excess unprotected ADIT.

8

9

10 **III. EXCESS ADIT AND THE TAX CUTS AND JOBS ACT OF 2017**

11

12 **Q. PLEASE GENERALLY DESCRIBE THE TCJA.**

13 **A.** The TCJA was enacted by the United States Congress on December 20, 2017, and was
14 signed into law by the President on December 22, 2017. See Tax Cuts and Jobs Act of
15 2017, Pub. Law 115-97, 131 Stat. 2054 (2017). The TCJA amends the IRC and contains
16 the most significant set of changes to the federal income tax laws since the Tax Reform Act
17 of 1986. The TCJA makes major changes in many areas of our nation's tax laws, some of
18 which directly affect regulated utilities like PNM.

19

20 **Q. PLEASE DESCRIBE THE PROVISIONS OF THE TCJA THAT HAVE THE**
21 **GREATEST IMPACT ON REGULATED UTILITIES LIKE PNM AND THEIR**
22 **CUSTOMERS.**

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1 **A.** The TCJA has significant, though varying, impacts on most utilities in terms of reported
2 tax expenses charged against the Company’s operations, cash flows, and the calculation of
3 revenue requirements and cost of service.

4
5 The most significant provision of the TCJA for regulated utilities, including PNM, is the
6 reduction of the Federal Income Tax Rate from 35 percent to 21 percent, which reduced
7 current income tax expense and originating deferred tax expense. Further, as a result of the
8 lower 21 percent income tax rate becoming effective under the TCJA, all companies,
9 including utilities, were required under ASC 740 to “remeasure,” as of December 31, 2017,
10 the amounts of ADIT in their financial statements.

11

12 **Q. WHAT ARE “EXCESS” ADIT AND HOW ARE THEY CALCULATED?**

13 **A.** Excess ADIT represents the portion of the ADIT balance existing immediately prior to the
14 reduction in the corporate tax rate (the ADIT balance at December 31, 2017) less the amount
15 that would have been in the ADIT balance had that balance been determined using the
16 revised lower corporate income tax rate. In effect, a portion of the “interest free loan from
17 the U.S. Treasury” has been forgiven. In other words, if there was an existing book-tax
18 difference of \$10 million with \$3.5 million of ADIT (at a 35% tax rate) at December 31,
19 2017, remeasuring the ADIT using the lower 21% income tax rate provided in the TCJA,
20 would result in a remeasured ADIT of \$2.1 million (the \$10 million book-tax difference
21 times 21%), producing a \$1.4 million excess ADIT (\$3.5 million minus \$2.1 million = \$1.4

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1 million). This is the calculated benefit from the effective forgiveness of the Treasury's
2 interest free loan.

3

4 **Q. IF THE BOOK-TAX DIFFERENCE EXISTING AT DECEMBER 31, 2017 WAS AN**
5 **ADIT ASSET, WOULD REMEASURING THAT DIFFERENCE RESULT IN A**
6 **DEFICIENT ADIT?**

7 **A.** Yes. To the extent that an ADIT Asset existed prior to the TCJA (for items where
8 cumulative book deductions are in excess of cumulative tax deductions), upon
9 remeasurement at the lower 21% statutory rate, a "deficient" ADIT results. For example, if
10 a book-tax difference of \$10 million with \$3.5 million of an ADIT Asset existed at
11 December 31, 2017 (recorded at a 35% statutory income tax rate) and the statutory tax rate
12 was reduced to 21%, a deficient ADIT (opposite of an excess ADIT) of \$1.4 million (\$10
13 million book-tax difference times 35% tax rate minus 21% tax rate) results.

14

15 **Q. WHAT IS THE ACCOUNTING FOR EXCESS ADIT?**

16 **A.** Under GAAP, for enterprises in general, the remeasurement of ADIT reduces the ADIT
17 balance, with a corresponding reduction in income tax expense. In my simple example
18 above, the \$1.4 million reduction of ADIT upon remeasurement would result in a \$1.4
19 million reduction (or increase if an ADIT Asset exists) in income tax expense in the period
20 of remeasurement, year-end 2017. However, for rate-regulated entities subject to ASC
21 980, the reduction in ADIT is subject to rate regulation. As a result, instead of immediately
22 reducing income tax expense upon remeasurement of ADIT, regulated utilities, including

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1 PNM, reclassified the reduction in ADIT to a regulatory liability representing the excess
2 ADIT that will be used to reduce future revenue requirements. Thus, in the examples
3 above, an income tax related regulatory liability or, in the case of an ADIT Asset, an
4 income tax related regulatory asset would initially be recorded upon remeasurement. In
5 the remainder of my testimony, I primarily use the term “excess ADIT and income tax
6 related regulatory liabilities” for remeasuring ADIT Liabilities but recognize “deficient
7 ADIT and income tax related regulatory assets” is the term applied to remeasuring ADIT
8 Assets.

9
10 **Q. DOES THE DIFFERENCE RESULTING FROM THE REMEASUREMENT OF**
11 **ADIT UPON A CHANGE IN TAX RATES REPRESENT THE ENTIRE EXCESS**
12 **ADIT REGULATED LIABILITY?**

13 **A.** No. Because reductions in income tax expense will reduce revenue requirements and those
14 reduced revenue requirements will affect income taxes, the excess ADIT regulatory liability
15 needs to be “grossed-up” for income taxes at the previously described gross-up rate, with
16 an ADIT offset. At the previous 35 percent federal income tax rate, revenue of \$1.5385 was
17 required to provide \$1.00 of after-tax income. A corporate tax rate of 21 percent requires
18 \$1.2685 of revenue to generate \$1.00 of after-tax income. A separate New Mexico state
19 income tax rate of 5.9 percent currently exists. The New Mexico tax rate is deductible for
20 federal income tax purposes (and deductible for the state) so the “combined federal and state
21 income tax rate” has gone from 38.80 percent to 25.54 percent. The combined income tax
22 gross-up factor before and after the TCJA has been reduced from 1.634 (pre-TCJA) to

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1 1.3405 (after TCJA). The additional “gross-up” entry would increase the income tax-related
2 regulatory liability or income tax-related regulatory asset (in the case of an ADIT Asset)
3 with an offset to ADIT.

4

5 **Q. DO THE EXCESS ADIT REPRESENT AMOUNTS (LOANS) FROM THE**
6 **UTILITY’S CUSTOMERS?**

7 **A.** No, and this is an important point. As I have previously stated, ADIT and excess ADIT
8 constitute interest-free loans from the US Treasury. Ratepayers do not pay ADIT. For
9 every dollar of ADIT, there has been an equal and offsetting reduction of current income
10 taxes. The revenue requirement is unaffected by book-tax timing/temporary differences.
11 Further, ADIT and excess ADIT (until used to reduce revenue requirements) typically
12 reduce rate base. The FERC, in a recent Order on Rehearing, reiterated their position that
13 “ratepayers have no ownership interest in ADIT.” *See* Order on Rehearing in Docket No.
14 PL17-1-001, Paragraphs 15-16. Also, in FERC Order 144, it addresses “the erroneous
15 premise that a loan is being made by ratepayers to utilities through the normalization process
16 and stating that ratepayers do not have any an ownership claim or equitable entitlement to
17 the loaned monies.” Order No. 144, FERC Stats. & Regs. ¶ 30,254 at 31,539.

18

19 **Q. PLEASE EXPLAIN HOW THE REDUCTION IN THE FEDERAL CORPORATE**
20 **INCOME TAX RATE AFFECTED PNM’S ADIT, INCLUDING EXCESS ADIT.**

21 **A.** The Company calculated the excess ADIT amounts at December 31, 2017 by comparing
22 the ADIT existing at that date to the ADIT that would have been recorded had the lower 21

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1 percent income tax rate always been in effect. The difference is the deficient/excess ADIT.
2 The deficient/excess ADIT were then separated into two “buckets”: Excess ADIT relating
3 to protected book-tax differences and excess ADIT relating to unprotected book-tax
4 differences. The reason for separating the excess ADIT in this manner is because of
5 different ratemaking treatment, in some cases required, for the reversal.
6

7 **Q. DID THE TCJA DISCUSS HOW REGULATED PUBLIC UTILITIES WERE TO**
8 **PASS PROTECTED EXCESS ADIT TO CUSTOMERS?**

9 **A.** Yes. The TCJA addressed how ADIT on protected book-tax differences are to be treated in
10 the ratemaking process. Protected book-tax differences include depreciation-related method
11 and life differences, as well as NOL carryforwards. The TCJA requires that excess ADIT
12 on such protected book-tax differences reduce customer rates over the book lives of the
13 related property no more rapidly than under ARAM, which I will describe subsequently. If
14 the necessary books and records are not available to compute the reversal under ARAM, an
15 alternative approach, referred to as the Reverse South Georgia Method (“RSGM”), can be
16 used, which I also will describe subsequently. The choice of ARAM or RSGM is not
17 optional, as ARAM must be used unless the records needed to compute ARAM are not
18 available.

19
20 **Q. IF THERE IS AN INCREASE IN THE CORPORATE INCOME TAX RATE,**
21 **WOULD ADIT HAVE TO BE REMEASURED?**

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1 **A.** Yes. If and when the federal or state statutory income tax rate increases, following the same
2 logic as discussed above, the ADIT would need to be remeasured. However, instead of an
3 “excess” ADIT, there would likely be a “deficient” ADIT that would need to be addressed,
4 and the creation of a new, net regulatory asset would be recorded and ultimately collected
5 from customers, or the current net regulatory liability, would be subsequently reduced if one
6 still exists.

7

8 **Q.** **HOW IS THE RSGM COMPUTED?**

9 **A.** The RSGM is straightforward: Determine the excess ADIT and spread the amount over the
10 estimated remaining useful lives of the assets giving rise to the excess ADIT.

11

12 **Q.** **HOW IS THE ARAM COMPUTED?**

13 **A.** The ARAM requires the development of an average rate, representing the tax rate that had
14 been used to determine the existing ADIT. This average rate is calculated by dividing the
15 ADIT existing at the time the tax rate changes by the cumulative book-tax differences from
16 which the ADIT balance was derived. The average rate calculated is applied to reversing
17 timing differences to derive the deferred taxes that are credited to income tax expense.
18 Under this approach, protected ADIT are reduced over the remaining lives of the property,
19 which gave rise to the ADIT as the timing/temporary differences reverse. Public utilities
20 must take care to properly apply the ARAM to protected ADIT because a normalization
21 violation could occur if the amount of protected excess ADIT is reduced more rapidly or to
22 a greater extent than under the ARAM. If the normalization rules were so violated, two
23 negative results would occur: 1) current income taxes would become payable for the more

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1 rapid reduction plus, more importantly, 2) accelerated depreciation methods would not be
2 permitted for income tax purposes going forward. Rather, book depreciation would have to
3 be used for income tax purposes.

4

5 **Q. HAVE YOU PREPARED AN EXHIBIT THAT DEMONSTRATES HOW THE**
6 **ARAM IS TO BE CALCULATED?**

7 **A.** Yes, PNM Exhibit ADF-2 provides an example describing the originating and reversing
8 book-tax differences and the required ADIT each year when there is a change (in this case,
9 a reduction) in the federal income tax rate. This example is based on the assumptions used
10 in my previous example describing depreciation book-tax differences and how such
11 differences originate and reverse. I begin with an income tax rate of 35 percent in the early
12 years that is reduced to 21 percent before the asset is fully depreciated. The example again
13 assumes a \$1 million asset placed in service in 2016 with a 10-year book-life and a five-
14 year tax return depreciation deduction using the Modified Accelerated Cost Recovery
15 System (“MACRS”) allowed by the IRC, with no bonus tax depreciation. The MACRS rate
16 is shown in Column B and each year’s tax depreciation is shown in Column C. Book
17 depreciation is \$100,000 each year and Column E contains the difference between tax and
18 book depreciation each year. Column F contains the cumulative difference between book
19 and tax at the end of each year. Column G contains the income tax rates, beginning with 35
20 percent in 2016 and 2017, reducing that rate to 21 percent at the beginning of 2018.
21 Columns H and I show each year’s deferred tax expense, with Column H showing the
22 deferred tax expense on originating book-tax differences and Column I showing the deferred
23 tax expense on reversing book-tax differences. Column J shows the ADIT balance,
24 increasing and decreasing the previous year’s balance by the deferred tax expense. Column

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1 M shows the excess ADIT balance, decreasing as it reverses according to the ARAM
2 methodology.

3

4 **Q. CAN YOU WALK THROUGH YOUR EXAMPLE SHOWING THE**
5 **DETERMINATION OF EXCESS ADIT AND HOW THE ARAM IS USED TO**
6 **REVERSE THE ADIT FOR THE TAX RATE CHANGE?**

7 **A.** Yes. When the tax rate changed at the end of 2017, the balance of ADIT was \$112,000
8 (Column J). This balance was derived by applying the 35 percent tax rate to the cumulative
9 book-tax differences at that time in Column F (\$320,000). The remeasurement necessitated
10 by the change in tax rates is shown on Line 2a where the ADIT balance at December 31,
11 2017 is allocated into two components: The “normal” ADIT amount and the excess ADIT
12 amount. The normal ADIT balance is calculated by applying the new 21 percent tax rate to
13 those cumulative book-tax differences at the time of the rate change ($\$320,000 \times 21$ percent
14 = \$67,200) and comparing that amount to the then-existing ADIT balance with the
15 difference representing the excess ADIT ($\$112,000 - \$67,200 = \$44,800$).

16

17 Under the ARAM, this excess ADIT balance does not begin reversing until 2021 when the
18 book-tax difference begins to reverse. In 2018 through 2020, book-tax differences continue
19 to originate, now at the lower 21 percent income tax rate with no reversal permitted for
20 excess ADIT.

21

22 At the end of 2020, the combined ADIT and excess ADIT balance is \$137,704 (Column H:
23 $\$35,000 + \$77,000 + \$19,320 + \$3,192 + \$3,192$) and the cumulative book-tax difference is
24 \$442,400 (the 2016 through 2020 differences in Column F). The average rate at which the

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1 \$137,704 combined ADIT and excess ADIT balance was accumulated is thus 31.1266
2 percent ($\$137,704 / \$442,400$). This is the average rate that must be applied to the book-
3 tax differences reversing in each year beginning in 2021 (Column E) broken into two
4 components: 1) the statutory rate (21 percent) applied to the reversing book-tax differences
5 beginning in 2021 to reduce the normal ADIT balance (Column I); and 2) the excess ADIT
6 rate (31.1266 percent minus 21 percent = 10.1266 percent, shown in Column K) also applied
7 to the reversing book-tax differences beginning in 2021.

8

9 At the end of its useful life, the originating and reversing deferred tax expense (consisting
10 of both the normal ADIT reversal plus the excess ADIT reversal) equal one another and the
11 ADIT balance is zero.

12

13 **Q. HOW IS THIS TYPICALLY REFLECTED IN A RATE CASE?**

14 **A.** Reversal of ADIT is a separate component included in the normal calculation of income tax
15 expense (i.e., the statutory rate multiplied by pre-tax net income). Once the normal
16 calculation of income tax expense is determined, the reversal of the deficient or excess
17 ADIT is added/subtracted to obtain the amount that is included in the calculation of revenue
18 requirement.

19

20 **Q. IN YOUR ARAM EXAMPLE, IF A RATE HIGHER THAN THE COMBINED**
21 **AVERAGE RATE OF 31.1266 PERCENT WERE USED TO REDUCE THE**
22 **REVERSING ADIT OR IF ANY OF THE EXCESS ADIT WERE REVERSED**
23 **PRIOR TO 2020, WHAT WOULD HAPPEN?**

24 **A.** Flowing back protected ADIT more rapidly than permitted under the ARAM will result in

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1 a violation of the normalization rules.³ I have already discussed the two-fold penalty for
2 violating the normalization rules for excess ADIT: (1) currently payable income tax is
3 increased by the amount by which the utility reduced its excess tax reserve more rapidly
4 than permitted under the ARAM or the RSGM, and (2) the utility will be unable to claim
5 accelerated depreciation for income tax purposes.

6

7 **Q. DOES THE TCJA PRESCRIBE A METHOD FOR REVERSING EXCESS ADIT ON**
8 **“UNPROTECTED” EXCESS ADIT?**

9 **A.** No. Prior to the TCJA, the ADIT provided on all book-tax differences typically reversed at
10 the tax rate used to record the deferred tax expense when the book-tax difference originated;
11 however, the TCJA does not contain such a requirement on the excess ADIT on unprotected
12 book-tax differences. Thus, reversal of the balance of unprotected ADIT is a decision by
13 the utility and its regulator.

14

15 **Q. HAS THE IRS ISSUED GUIDANCE ON THE IMPLEMENTATION OR**
16 **APPLICATION OF ARAM OR ON OTHER MATTERS RELATING TO THE**
17 **TCJA?**

18 **A.** Yes. The IRS has issued Rev. Proc. 2020-39 providing guidance on certain ratemaking
19 issues that have arisen or are anticipated to arise due to the corporate income tax rate
20 reduction. PNM complies with the IRS normalization guidance but if and to the extent that

³ Section 168(i)(9) of the IRC of 1986, as amended ("Code"), Treas. Reg. § 1.167(l)-1, former § 167(l) of the Code, and section 13001(d) of the Tax Cuts and Jobs Act, Pub. L. 115-97.

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1 this guidance as well as future guidance resulting from the IRS issuing private letter rulings
2 turn out to be contrary to positions taken by PNM, it is important that adjustments are made
3 to comply. Said another way, to the extent that the IRS guidance is contrary to
4 deficient/excess ADIT positions taken prior to such guidance, utilities and regulators,
5 including PNM and the Commission, should be allowed to implement any required
6 adjustments to comply with such requirements.

7

8 **Q. ARE THERE OTHER ISSUES BEING ADDRESSED BY THE IRS IN NOTICE**
9 **2019-33 THAT MAY AFFECT THE COMPANY?**

10 **A.** One other issue that impacts the excess ADIT calculation is the treatment of cost of removal.
11 The IRS has recently ruled that the book-tax difference related to cost of removal is not
12 protected by the normalization rules. The accounting and income tax treatment creates a
13 book-tax difference on which ADIT is provided. For book purposes, cost of removal is
14 accrued over the book life of the related property, plant and equipment as a component of
15 book depreciation. The composite book depreciation rate includes an estimate for the
16 eventual cost to remove the asset or be received as salvage. For income tax purposes, cost
17 of removal or salvage is recognized in the period the removal cost is paid or when salvage
18 amounts are received. There is diversity in practice as to whether the ADIT (and excess
19 ADIT) related to cost of removal is a protected book-tax difference subject to ARAM or
20 whether it is unprotected. The Company has historically treated the excess ADIT on cost
21 of removal as a protected book-tax difference.

22

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1 **Q. IF RECENT IRS GUIDANCE CONCLUDING THAT COST OF REMOVAL IS**
2 **UNPROTECTED AND THE COMPANY HAS HISTORICALLY TREATED THE**
3 **ADIT AND EXCESS ADIT RELATED TO THAT BOOK-TAX DIFFERENCE AS**
4 **PROTECTED, WHAT IS THE ISSUE YOU ARE ADDRESSING?**

5 **A.** The issue concerns how the ARAM reversal has been calculated. As I stated, under ARAM,
6 the excess ADIT reverses when the related book depreciation reverses. The Company had
7 been calculating the reversal ARAM using the book depreciation rate, which contains
8 factors to recover both depreciation expense over the estimated book life as well as the cost
9 of removal. By reversing ARAM using the combined depreciation rate, the reversal of
10 excess ADIT using ARAM is occurring too rapidly, which does not comply with the IRC
11 normalization rules.

12

13 **Q. CAN YOU ILLUSTRATE THE ISSUE WITH AN EXAMPLE?**

14 **A.** Yes. Assume a \$1 million fixed asset is placed in service and has an estimated book life of
15 10 years. Annual depreciation expense in years one to ten to recover that fixed asset would
16 be \$100,000 (\$1 million divided by 10=\$100,000). The annual depreciation rate applied to
17 the fixed asset cost is 10% (1 divided by 10=10%). In addition, it is estimated that when
18 the asset is retired after year 10, a cost of \$50,000 will be incurred. In order to recover that
19 estimated removal cost from the customers who are using that fixed asset, an expense of
20 \$5,000 each year is necessary, which is recorded as a component of depreciation expense
21 (or, if a net salvage was anticipated, depreciation expense would be reduced). Thus, annual
22 depreciation expense to recover both the fixed asset cost over the estimated book life plus

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1 an estimated removal factor is \$105,000. Converting this annual expense into a rate to apply
2 to the fixed asset cost yields a composite rate of 10.5%.

3

4 The issue at hand concerns the rate used to calculate ARAM. The Company had been using
5 the 10.5% composite depreciation rate instead of the life-only rate 10%. In this manner, the
6 excess ADIT are being reversed too quickly and PNM must slowdown that reversal so that
7 the ARAM rate reflects the life-only factor rate.

8

9 Said another way, if PNM were to continue using the composite rate, which is higher than
10 the life-only factor of the rate, the excess ADIT will be returned to customers before the
11 fixed asset is fully depreciated.

12

13 **Q. WHAT IS PNM PROPOSING IN THIS RATE CASE FOR THIS ISSUE?**

14 **A.** The ARAM run out for protected excess ADIT is based on the life-only rate rather than the
15 total depreciation rate. In this manner the book depreciation rate at which ADIT reverses
16 under ARAM, PNM complies with the revised IRS guidance,

17

18 **Q. DID THE COMMISSION PREVIOUSLY REQUIRE REGULATED UTILITIES TO**
19 **DO ANYTHING WITH THE CHANGE IN THE FEDERAL AND STATE INCOME**
20 **TAX RATE?**

21 **A.** Yes. The Commission required regulated utilities, such as PNM, to quantify the excess
22 ADIT and propose an approach to pass the excess ADIT to ratepayers.

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1 **Q. HOW DID PNM RESPOND TO THIS COMMISSION REQUIREMENT?**

2 **A.** The Company reached a settlement on this issue and began returning excess ADIT using a
3 RSGM (straight-line over the estimated remaining book life) approach for the entire
4 calculated excess over a 23- year period beginning February 1, 2018. RSGM was used as,
5 at that time, PNM was unsure as to whether their records would support application of
6 ARAM. Subsequently, it was determined that their records were adequate and, thus,
7 required ARAM for reversal of the protected excess ADIT. An update to the settlement
8 occurred in a Phase II compliance filing (for rates beginning January 1, 2019) in which the
9 change to ARAM was reflected. The reversal of unprotected excess ADIT was adjusted to
10 keep the total annual amortization the same as in the settlement.

11

12 **Q. HOW ARE THE PROTECTED EXCESS ADIT BEING TREATED IN THIS RATE**
13 **CASE?**

14 **A.** Protected ADIT are being reversed using ARAM as required by the IRC. In this case, the
15 reversal of protected excess ADIT in the Test Period is \$8.2 million. As stated above, the
16 ARAM calculation has been updated to exclude the cost of removal factor embedded in the
17 composite book depreciation rate. To comply with the IRC, no more than this amount can
18 be used to reduce customer rates. This amount reduces income tax expense, and it turn, the
19 revenue requirement by the gross-up of this reversal.

20

21 **Q. HOW ARE THE UNPROTECTED EXCESS ADIT BEING TREATED IN THIS**
22 **RATE CASE?**

23 **A.** The Company is proposing to accelerate the reversal period for unprotected excess ADIT
24 amounts from the current 23 years to five years. This five-year reversal period is reasonable

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1 as it returns the excess ADIT closer to the period that such amounts have been accumulated.
2 The amount of unprotected ADIT reversal included in this rate filing is approximately \$12.5
3 million. This amount also reduces income tax expense, and in turn, the revenue requirement
4 by the gross-up of this reversal.

5

6 **Q. HOW ARE THE REMAINING, UNREVERSED EXCESS ADIT BALANCES**
7 **TREATED IN THE RATE FILING AND DO SUCH BALANCES REDUCE RATE**
8 **BASE?**

9 **A.** Yes. The remaining excess ADIT balance reduces rate base providing the benefit of cost-
10 free capital to customers until such amounts are passed to them. The unamortized excess
11 ADIT balances included in the Test Period reducing rate base are as follows. The amounts
12 are calculated using a 13-month average to be consistent with the rate base calculation.

13

Remaining Protected Excess ADIT (reversing under ARAM):	\$149.6 million
Remaining Unprotected Excess ADIT (reversing over five years):	\$56.5 million
Total	\$206.1 million

14

15

16

IV. SUMMARY

17

18 **Q. CAN YOU SUMMARIZE YOUR TESTIMONY?**

19 **A.** As a result of the TCJA, all companies, including PNM, were required to remeasure their
20 ADIT balance for the statutory tax rate reduction from 35% to 21%. As a regulated entity,
21 PNM must follow the IRS guidance for returning the difference, excess ADIT, to its
22 customers. Such IRS guidance requires protected excess ADIT to reverse using ARAM.

**DIRECT TESTIMONY
OF ALAN D. FELSETHAL
NMPRC CASE NO. 22-00270-UT**

1 PNM has calculated the ARAM reversal for the Test Period and included this amount in the
2 filing as a reduction to income tax expense. It is important that the reversal of protected
3 ADIT comply with the IRS guidance to prevent a normalization violation. The filing also
4 includes a reduction to calculated income tax expense for the reversal of unprotected ADIT.
5 This reversal has been accelerated from 23 years to five-years.

6

7 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

8 **A.** Yes, it does.

GCG#530049

9

Curriculum Vitae

PNM Exhibit ADF-1

Is contained in the following 13 pages.

CURRICULUM VITAE
ALAN D. FELSENTHAL

EDUCATIONAL BACKGROUND

June, 1971	B.S. in Accounting University of Illinois Champaign, Illinois
May, 1972	Certified Public Accountant

EMPLOYMENT

2010-	Managing Director, Power and Utilities and member of PricewaterhouseCoopers LLP's Complex Accounting and Regulatory Solutions ("CARS") practice.
2008-2010	Managing Director-Utilities Industry Huron Consulting Group
2002-2007	Managing Director—Utilities Industry PricewaterhouseCoopers LLP
1985-2002	Principal in Utilities and Telecommunications Practice, Arthur Andersen LLP, Chicago
1976-1985	Manager in Utilities and Telecommunications Practice, Arthur Andersen LLP, Chicago
1971-1976	Staff and Senior Accountant, Arthur Andersen LLP, Utilities and Telecommunications Division, Chicago

TESTIMONY EXPERIENCE

Testified before the Illinois Commerce Commission on behalf of Town Gas Company of Illinois, 1985. Accounting witness covering cost of service issues.

Testified before the Illinois Commerce Commission on behalf of Town Gas Company of Illinois, 1986. Generic hearing regarding high gas costs.

Testified before the Florida Public Service Commission on behalf of Central Telephone Company of Florida (1991). Testimony addressed projected test year,

a computer model we developed to simplify forecast procedures and propriety of including pension asset in rate base.

Submitted an expert report and testified in an appeal by Yellow Cab Company versus the City of Chicago, (2000). Topic dealt with the adequacy of taxicab lease rates. Yellow Cab was appealing the lease rates they were permitted to charge lessees. The model developed by the City of Chicago to set lease rates was based on traditional utility ratemaking principles. Was hired by the City of Chicago to review Yellow Cab's appeal compared to traditional ratemaking principles and submit a report. Yellow Cab appealed the decision and a hearing before a judge resulted.

Testified before the Arizona Corporation Commission on behalf of Tucson Electric Power Company, 2008. Rebuttal testimony addressed application of FAS 71 when a portion of the business was opened to competition and appropriate treatment of the FAS 143 cost of removal regulatory liability.

Testified before the Florida Public Service Commission on behalf of Tampa Electric Company and Peoples Gas, (2008). Direct testimony on income taxes, including the appropriate accumulated deferred income tax calculation when a projected test period is used.

Testified before the Washington Utilities and Transportation Commission on behalf of Avista Corporation, (2008).

Testified before the Illinois Commerce Commission on behalf of The Peoples Gas, Light and Coke Company/North Shore Gas Company (2009). Rebuttal and Surrebuttal testimony on the appropriate treatment of prepaid pension asset in rate base.

Testified before the Indiana Utility Regulatory Commission on behalf of Northern Indiana Public Service Company (2009). Rebuttal testimony on the appropriate treatment of cost of removal vis a vis FAS 143.

Submitted an expert report and a reply expert report to a Seattle-based arbitration panel in a dispute involving Grays Harbor Energy LLC vs. Energy Northwest, 2009. Subject involved the appropriate determination of fixed costs and cost of capital pursuant to a purchase and sale agreement.

Testified before the Public Utility Commission of Texas on behalf of CenterPoint Energy (2010). Direct and Rebuttal testimony on a number of income tax issues including consolidated income tax adjustments and FIN 48.

Testified before the Indiana Utility Regulatory Commission on behalf of Indianapolis Power & Light Company (2015). Rebuttal testimony on including prepaid pension asset in rate base.

Testified before the Public Utility Commission of Ohio on behalf of Dayton Power & Light Company (2015). Direct testimony on the results of a lead-lag study.

Submitted rebuttal testimony to the Indiana Utility Regulatory Commission on behalf of Northern Indiana Public Service Company (2016) on the appropriateness of including the prepaid pension asset in rate base.

Submitted an expert report to the Virginia State Corporation Commission regarding the allocation of Dominion Resources Inc. shared service costs to Virginia Electric Power Company (2016).

Submitted an expert report to the Oregon Public Service Commission regarding the capitalization of administrative and general overhead costs. (2017).

Testified before the Florida Public Service Commission on behalf of Tampa Electric Company and Peoples Gas on the subject of the appropriate treatment of excess Accumulated Deferred Income Taxes resulting from the Tax Cuts and Jobs Act (2018).

Testified before the Indiana Utility Regulatory Commission on behalf of Indianapolis Power & Light Company (2018). Rebuttal testimony supporting a return on the Company's prepaid pension asset.

Testified before the FERC on behalf of GridLiance West (2018). Direct testimony supporting the derivation and reasonableness of the Company's Start-Up Regulatory Asset.

Submitted rebuttal testimony to the Indiana Utility Regulatory Commission on behalf of Northern Indiana Public Service Company (2019) on reasons why including a return on the Company's prepaid pension asset is appropriate.

Submitted direct testimony to the New Jersey Board of Public Utilities on behalf of Elizabethtown Gas Company (2019) discussing consolidated income tax adjustments and Excess Accumulated Deferred Income Taxes being passed on to customers after the acquisition of the Company from Southern Company by South Jersey Industries.

Submitted direct testimony to the Hawaii Public Utilities Commission on behalf of Young Brothers (2019) on a number of income tax topics (Excess Accumulated Deferred Income Taxes, including the NOL Deferred Tax Asset in Rate Base, treatment of the Hawaii Capital Goods Excise Tax Credit) and including the prepaid pension asset in rate base.

Participated on accounting panels before the Maine Public Utilities Commission supporting 1) a market study of Central Maine Power Company's shared service costs and 2) the treatment of Excess Accumulated Deferred Income Taxes (2019).

Submitted rebuttal testimony before the Utah Public Service Commission on pension accounting symmetry in connection with the rate case of Dominion Energy Utah (2019).

Submitted direct testimony to the New Jersey Board of Public Utilities on behalf of South Jersey Gas Company (2020) discussing consolidated income tax adjustments and Excess Accumulated Deferred Income Taxes being passed on to customers using the Average Rate Assumption method for protected book-tax differences to comply with the Tax Cuts and Jobs Act.

Participated on a panel before the Connecticut Public Regulatory Authority supporting GenConn Energy LLC's Accumulated Deferred Income Taxes in their Revenue Requirement proceeding (2020).

Submitted direct and rebuttal testimony and was cross-examined before the Public Service Commission of West Virginia for Dominion Energy West Virginia (Hope Gas) supporting 1) the treatment of excess Accumulated Deferred Income Taxes 2) why it is inappropriate to include Accumulated Deferred Income Tax and Excess Accumulated Deferred Income Tax balances as a rate base offset when the book-tax difference relates to costs not being recovered in revenue requirements 3) the need for consistency between the treatment of pension expense (credit), the prepaid pension asset and the related pension-related ADIT and 4) the inappropriateness of including a parent company loss adjustment. (2020/2021)

Submitted direct and rebuttal testimony and was cross-examined before the Public Service Commission of Missouri supporting Spire Missouri, Inc.'s 1) treatment of

pension costs 2) the need to include the NOL ADIT Asset in rate base and 3) the appropriate treatment of excess ADIT (2020/2021).

Submitted direct testimony to the New Jersey Board of Public Utilities on behalf of Elizabethtown Gas Company (2021) discussing consolidated income tax adjustments and Excess Accumulated Deferred Income Taxes being passed on to customers using the Average Rate Assumption method for protected book-tax differences to comply with the Tax Cuts and Jobs Act.

Participated in a hearing before the New Brunswick Energy and Utilities Board on behalf of Liberty Utilities (Gas New Brunswick) LP (2022) in connection with a rate proceeding (Matter 494) addressing the scope, findings and results from PwC's assessment of the Cost Allocation Manual for Algonquin Power and Utilities Corp. (the "CAM Assessment") followed by the Company.

Submitted direct testimony to the New Jersey Board of Public Utilities on behalf of South Jersey Gas Company (2022) discussing consolidated income tax adjustments and Excess Accumulated Deferred Income Taxes being passed on to customers using the Average Rate Assumption method for protected book-tax differences to comply with the Tax Cuts and Jobs Act.

Submitted reply testimony to the Regulatory Commission of Alaska on behalf of Doyon Utilities LLC (2022) regarding why recovery and return on certain cancelled projects is appropriate and supported by the FERC and NARUC USoA's,

Submitted rebuttal and rejoinder testimony in Arizona on behalf of Liberty Utilities (Entrada Del Oro Sewer) corp. and Liberty Utilities (Gold Canyon Sewer) Corp. (2022) on the subject of capitalization of indirect overhead costs.

REGULATORY CONSULTING EXPERIENCE

Synopsis—Throughout the late 1970's, the 1980's, 1990's, 2000's, 2010's and 2020's assisted Andersen and PwC partners in the preparation of regulatory testimony covering a variety of accounting issues. Much of this testimony involved income tax accounting issues related to flow-through versus normalization or investment tax credit and the appropriate accounting and ratemaking treatment of excess accumulated deferred income taxes when statutory tax rates change. Also developed testimony on CWIP in rate base and working capital (lead-lag technique), appropriateness of allocation of service company costs to regulated entities, recovery of pre-operating cost regulatory assets and capital structure issues. Below are examples of such advisory/consulting projects.

In 2015, assisted with the preparation of an Expert Report for EverSource Energy subsidiary Connecticut Light & Power which was submitted to the Connecticut regulator. The issue concerned reopening a rate order to address the treatment of accumulated deferred income taxes which was incorrectly decided in the rate order.

In 2018, assisted with the preparation of a private letter ruling by American Transmission Company as to whether an internal transfer between a regulated and non-regulated partner would trigger the elimination of accumulated deferred income taxes that would need to be reflected on the books and records of the partnership.

In 2018, assisted with the preparation of an Expert Report for Enmax (in Alberta, Canada) supporting the capitalization of overheads. Issue involved explaining the increase in capitalized overheads compared to the prior rate case filing.

In 2018 and 2019, assisted with the preparation of Expert testimony and a private letter ruling discussing the appropriate income tax treatment of a like-kind

exchange between Oncor and Sharyland. The issue concerned whether the accumulated deferred income taxes relating to the exchanged assets could carry over or would need to be eliminated.

In 2020-2021, assisted in developing support for Hydro One's overhead capitalization in which PwC issued a report.

In 2021, performed time studies to support overhead capitalization for Liberty Utilities as well as reviewing the Company's cost allocation manual for compliance with FERC USoA and NARUC guidelines potential improvements.

In 2021, supported rebuttal testimony for Southwestern Power on the issue of including the deficient NOL ADIT asset in rate base after the NOL itself had been utilized.

In 2021, issued an Expert Report for Liberty Utilities supporting the reasonableness of the Company's Cost Allocation Manual and that the procedures listed in the CAM were followed.

In 2021, supported rebuttal testimony for CenterPoint Arkansas supporting the removal of ADIT balances upon the sale of CenterPoint Arkansas asset.

In 2022, issued an Expert Report to Xcel Energy discussing various working capital approaches, focusing on cash working capital, and presenting the results of research performed to show which methodologies have been approved in various final orders/decisions.

Provided assistance on rate case testimony for the following companies:

- Ameritech Corporation
- Central Illinois Light Company
- Central Illinois Public Service Company
- Central Telephone Company of Florida

- Central Telephone Company of Nevada
- Central Telephone Company of Texas
- Connecticut Light and Power Company
- Dayton Power & Light Company
- Dominion Energy Utah
- Elizabethtown Gas Company
- El Paso Electric Company
- GridLiance Corporation
- Hawaiian Electric Companies
- Indiana Bell Telephone Company
- Indianapolis Power & Light Company
- Integrys Energy Group, Inc.
- Iowa-Illinois Gas and Electric Company
- Iowa Power Company
- Liberty Utilities
- New Mexico Gas Company
- Northern Indiana Public Service Company
- Pacific Gas & Electric Company
- Peoples Gas Systems (Tampa)
- PPL Montana (contract dispute)
- The Peoples Gas Light and Coke Company
- Public Service Company of New Mexico
- San Gabriel Valley Water Company
- Southern Bell Telephone Company
- South Jersey Gas Company
- Tampa Electric Company/Peoples Gas Company
- Transco Pipeline
- Young Brothers, Limited

Provided regulatory consulting for the Panama Canal Company. Tariffs charged to transit the Panama Canal were based on a cost of service approach. Assisted the Panama Canal Company in determining test year costs. Tariffs were established based on these costs.

2012-2021. Led several projects to evaluate a rate case filing prior to filing validating the completeness, accuracy, consistency and support of the filing. As a result, adjustments and edits were made to the filing to increase the credibility of the utility's filing. Provided a similar role with respect to date request responses and rebuttal testimony.

FINANCIAL CONSULTING EXPERIENCE

Assisted two Chinese utility companies in registration filings to have their shares traded on the New York Stock Exchange. Huaneng Power International and Shandong Huaneng Power Company were the first two Chinese utilities to list on the NYSE. Process involved working with attorneys, company personnel and the Securities and Exchange Commission to file the equivalent of a Form S-1.

Assisted a number of companies in the preparation, review and filing of Registration Statements with the SEC to raise debt and equity capital.

Consulted with an electric transmission company on whether costs charged to generation companies based on specific costs are in accordance with the costs permitted by the Federal Energy Regulatory Commission.

Consulted with Ameritech Corporation on a number of projects involving cost allocations and compliance with the Federal Communications Commission separations rules.

Consulted with several entities in the preparation of a private letter ruling request to determine whether certain regulatory/ratemaking approaches would violate the Internal Revenue Service (“IRS”) normalization rules. Provided the ratemaking aspect of the request when, combined with income tax consulting assistance formed the basis for a complete request, accepted by the IRS.

FINANCIAL AUDIT EXPERIENCE

- Allegheny Energy
- Ameritech Cellular
- Ameritech Corporation
- Ameritech New Media
- Centel Corporation
- Chicago Skyway
- Constellation Energy
- Focal Communications
- Iowa-Illinois Gas and Electric Company
- Louisville Gas and Electric Company
- Nicor, Inc.
- Nisource

- Peoples Energy
- United Airlines
- Utilities, Inc.

LECTURES AND SEMINARS

Speaker at Edison Electric Institute/American Gas Association Introductory, Intermediate and Advanced Accounting Seminar 1996-2021.

Speaker at SNL (Regulatory Research Associates) Utility Foundations Seminar 2013-2017

Speaker at Power Plan Associates annual conference (2012, 2010, 2008, 2006, 2004, 2002) on recent accounting, regulatory and SEC matters affecting utilities.

Developed and conducted Utilities Industry Basic Accounting and Ratemaking Seminar. This two-day seminar is conducted each year for Andersen, Huron and PwC personnel assigned to utility audits or projects. In addition, the seminar is periodically offered on an open-registration basis for utility company personnel as well as offered and conducted for specific utility companies at their training sites.

Developed and conducted Utility Income Taxes-Accounting and Ratemaking Issues. This two-day or two-and-a-half day seminar has been conducted each year for Andersen, PwC and Huron personnel assigned to utility audits or income tax projects. The seminar focus is the accounting, tax return/compliance and financial statement aspects of utility income taxes taking into consideration the consequences of ratemaking/revenue requirements. In addition, the seminar is conducted annually on an open-registration basis for utility company personnel as well as offered and conducted for specific utility companies at their training sites.

Developed and conducted Rate Case Experience Seminar, a week-long seminar taking participants through the process of filing a rate case, including preparing direct testimony based on a mock case study and sitting for cross-examination. At

the conclusion of the seminar, an Order is presented. The course is conducted each year on an open-registration basis for utility company personnel as well as offered and conducted for specific utility companies at their training sites.

Specific examples of special training conducts for utility companies/regulators are as follows:

- Alaska Regulatory Commission
- Alliant Energy
- American Electric Power
- American Water Works
- Ameritech Corporation
- Arizona Public Service Company
- Arkansas Public Service Commission
- CenterPoint Energy
- Cleco Corporation
- Consolidated Edison
- Consumers Power Company
- Dominion Resources
- Duke Energy
- Enbridge Pipeline
- Entergy Corporation
- Exelon Corporation
- Federal Energy Regulatory Commission
- Georgia Power Company
- Illinois Commerce Commission
- Integrys Corporation
- Invenenergy
- Louisville Gas and Electric Company
- National Grid
- Natural Gas Pipeline Company of America
- Nicor, Inc.
- NiSource, Inc.
- Northwest Pipeline
- Oklahoma Corporation Commission
- One Gas Corporation
- Pembina Pipeline
- Peoples Energy
- Pepco Holdings, Inc.
- PG&E Corporation
- Portland General Electric Company
- PPL Corporation
- Qwest Corporation
- Sempra Energy

- Southern California Edison Company
- Sprint Corporation
- Tampa Electric Company
- The Southern Company
- Transco Pipeline
- Tucson Electric Power
- Williams Pipeline
- Xcel Energy

PROFESSIONAL ASSOCIATIONS

American Institute of Certified Public Accountants

Illinois CPA Society

GCG#530050

Reversal of Excess ADIT Under ARAM

PNM Exhibit ADF-2

Is contained in the following 1 page.

ARAM ILLUSTRATION

Line No.	Year	(A) Asset Cost	(B) 5-year MACRS Tax Rate	(A x B = C) Tax Depreciation	(A / 10 = D) Book Depreciation 10 yrs. S/L	(C - D = E) Tax over Book Difference		(G) Tax Rate	(E x G = H) Originating Deferred	(E x G = I) ADIT Reversing Deferred	(F x G = J) Cumulative ADIT Balance	(K) Average Excess ADIT Rate	(E x K = L) Excess ADIT Reversing under ARAM	(M) Excess ADIT Cumulative Balance
						Cumulative Tax Over Book Difference	Difference							
1	2016	1,000,000	20.000%	200,000.00	100,000.00	100,000.00	100,000.00	35%	35,000.00		35,000			
2	2017		32.000%	320,000.00	100,000.00	220,000.00	320,000.00	35%	77,000.00		112,000			
2a	Remeasurement at December 31, 2017													
			-	-	-	-	320,000.00	21%	-		67,200			44,800
3	2018		19.200%	192,000.00	100,000.00	92,000.00	412,000.00	21%	19,320.00		86,520			44,800
4	2019		11.520%	115,200.00	100,000.00	15,200.00	427,200.00	21%	3,192.00		89,712			44,800
5	2020		11.520%	115,200.00	100,000.00	15,200.00	442,400.00	21%	3,192.00		92,904			44,800
6	2021		5.760%	57,600.00	100,000.00	(42,400.00)	400,000.00	21%	-	(8,904)	84,000	10.1266%	(4,294)	40,506
7	2022		0.000%	-	100,000.00	(100,000.00)	300,000.00	21%	-	(21,000)	63,000	10.1266%	(10,127)	30,380
8	2023		0.000%	-	100,000.00	(100,000.00)	200,000.00	21%	-	(21,000)	42,000	10.1266%	(10,127)	20,253
9	2024		0.000%	-	100,000.00	(100,000.00)	100,000.00	21%	-	(21,000)	21,000	10.1266%	(10,127)	10,127
10	2025		0.000%	-	100,000.00	(100,000.00)	-	21%	-	(21,000)	0	10.1266%	(10,127)	0
Total				1,000,000.00	1,000,000.00	-			137,704.00	(92,904)			(44,800)	

\$1,000,000 fixed asset placed in service on January 1, 2016

Book Depreciation using straight-line method, 10-year life, no half-year convention

Tax Depreciation using MACRS, five-year life

(137,704)

At the end of 2017, when the tax rate changes, the ADIT is remeasured at 21%. The remeasurement reclassifies a portion of the ADIT as Excess ADIT. (line 2a)
The remeasured ADIT reverses normally (i.e. the book tax difference times the current statutory rate) while the Excess ADIT reverses following ARAM

Average Rate (Column K) computed when the book-tax difference reverses (Column E-Year 2021). Computation is based on dividing the Excess ADIT balance at the time of reversal (\$44,800 in Column M) by the cumulative book-tax differences at the beginning of the year (\$442,400 - the total originating differences in Column F). The average rate is 31.166 per cent, broken into 1) the statutory tax rate to apply to reversing book-tax differences (21 percent) to clear the ADIT balance (Column I) and 2) the rate to apply to reversing book-tax differences to clear the Excess ADIT balance (Column L).

Ratemaking tax expense includes both the deferred tax expense (i.e. originating deferred or reversing deferred) and rate base is reduced for both the Cumulative ADIT and Excess ADIT balances.

BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

**IN THE MATTER OF THE APPLICATION)
OF PUBLIC SERVICE COMPANY OF NEW)
MEXICO FOR REVISION OF ITS RETAIL)
ELECTRIC RATES PURSUANT TO ADVICE)
NOTICE NO. 595)
)
PUBLIC SERVICE COMPANY OF NEW)
MEXICO,)
)
Applicant)**

Case No. 22-00270-UT

SELF AFFIRMATION

ALAN D. FELSENTHAL, Managing Director, Pricewaterhouse Coopers, LLP,
upon penalty of perjury under the laws of the State of New Mexico, affirm and state: I have read
the foregoing **Direct Testimony of Alan D. Felsenthal** and it is true and accurate based on my
own personal knowledge and belief.

Dated this 5th day of December, 2022.

/s/ Alan D. Felsenthal
ALAN D. FELSENTHAL