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Witness: Brendan J. O'Brien, Garrett J. Murray and Timothy J. Griffin
Request from: Public Utilities Regulatory Authority

Question:

(DEFERRED INCOME TAXES) Application, Sch. C-3.41 and Sch. WP C-3.41. Regarding the deferred income tax expense:

a. (i) Explain the Test Year deferred income tax expense of $21,178,000 against the five-year average of $64,398,000; and (ii) identify each temporary difference driving the reduction and state whether the Test Year is representative.
b. Provide the derivation of the pro forma adjustment of $13,829,000 and of the Rate Year adjustment of negative $17,412,000, by temporary difference.
c. Explain: (i) the sign combination on the line item entitled Tax Depreciation on pages 1, 2, and 3 of Schedule WP C-3.41; (ii) the zero Connecticut amount on the line entitled Ld Powertax Adj - Accrual Estimate on pages 1, 2, and 3 of Schedule WP C-3.41; and (ii) the four line items on pages 1 and 2 of Schedule WP C-3.41 that show a $0 amount in the Test Year and Test Year pro forma and carry temporary differences of $3,268,000, negative $1,581,000, $775,000 and $225,000 in the Rate Year on page 3 of Schedule WP C-3.41.
d. (i) Provide the amortization schedule for the federal rate change amortization; (ii) reconcile Schedule C-3.41 to the accumulated deferred income tax balance of $1,263,352,000 in Schedule B-1.0; and (iii) provide the proration schedule and identify the averaging convention used.

Response:

a. Deferred income tax expense is dependent upon temporary differences, which are differences between how revenues and expenses are recognized for book purposes versus tax purposes. These temporary differences fluctuate year over year which causes the deferred income tax expense to fluctuate year over year. Any single period could be significantly different from another. Over the five-year period referenced, the main temporary differences driving the reduction is the result of activity within the tax depreciation, storm reserves and pension deferral categories. Of these items, storm-related temporary differences were a particularly significant driver of the variance. As shown in Exhibit CLP-REVREQ-2, WP C-3.26, Lines 28-32, catastrophic storm restoration costs were approximately $220.3 million in 2021 compared to $78.2 million in 2025. Applying the composite statutory income tax rate of 27.52% results in deferred tax impacts of approximately $60.6 million and $21.5 million, respectively, a reduction of approximately $39.1 million.

In addition, the Company's rate filing does not assume a timing difference between the recovery and incurrence of catastrophic storm costs during the rate year. Specifically, the Company proposes $60 million of catastrophic storm funding in rates (Schedule C-3.0, Line 43 of the same exhibit) and assumes those costs are incurred during the Rate Year. Therefore, with no timing difference related to these costs and the corresponding recovery, there is no related deferred tax expense reflected in the Rate Year. That is, where deferred income tax expense related to catastrophic storm costs was $60.6 million in 2021, the Rate Year has none.

Yes, the $21,178,000 is representative of the Test Year, as it is based on actual activity within the period.

b. Please refer to RRU-080, Attachment 1, which provides the temporary differences and its respective deferred tax expense derivation by proforma adjustment and by Rate Year adjustment.

c. i.) The sign combination related to line item description "Tax Depreciation" has to be looked at synonymously with two other line items descriptions "Section 263a Costs" and "Repairs." These three line items make up total "Tax Depreciation" which in totality has state deferred taxes as a positive amount.

ii) The line item LD Powertax Adj – Accrual Estimates has zero for Connecticut state deferred taxes, because it is related to several tax basis adjustments that are treated as flow through for state purposes and as a result there is no state deferred taxes associated with it. Basis adjustments that are treated as flow-thru for state are 263a, CIAC, and Capitalized Interest.

iii.)WP C-3.41 page 1 of 3 shows the Test Year current activity. The four lines had zero activity reflected in the Test Year and in the proforma Test Year. However, for Rate Year there was an increase in activity as shown in Schedule B-6.2, which was incorporated into the WP C-3.41 page 3 of 3. The temporary differences $3,268,000 (Deferred COVID-19 Costs and COVID-19 related Bad Debt), <$1,581,000> (Fee for Free Deferred (Over)/Under Recovery Dkt 17-10-46), $775,000 (Deferred Rate Case Expenses) and $225,000 (CT Management Audit) are new temporary differences included in this filing. The amounts represent the Rate Year activity as calculated using balances from Schedule B-6.2.

d. Please refer to RRU- 080, Attachment 2, which provides an amortization schedule for the Federal Rate change amortization. This schedule includes the actual balances as of December 31, 2018 to be amortized and reflects actual amortization through year 2025.

Estimated annual tax amounts are included thereafter. All amounts will be updated as the amortization process continues through completion under the Average Rates Assumption Method (ARAM).

The $1,263,353 is an average between the beginning and ending Rate Year 1 balances for the Accumulated Provision for Deferred Income Taxes. The actual difference between Rate Year 1 beginning balance and the ending balance is $24,342. Please refer to RRU-080 Attachment 3, which details the reconciliation of amounts to Schedule C-3.41