Paul A. Colbert
Associate General Counsel
Regulatory Affairs

January 31, 2018

Kathleen H. Burgess
Secretary
Public Service Commission
3 Empire State Plaza
Albany, NY 12223-1350

Re: Case 17-M-0815 – *Proceeding on Motion of the Commission on Changes in Law that May Affect Rates*; Central Hudson Gas & Electric Corporation's Comments and Responses

Dear Secretary Burgess:

Central Hudson Gas & Electric Corporation ("Central Hudson") hereby submits its comments and responses to the New York State Department of Public Service Staff's 2017 Tax Cuts and Jobs Act Letter, issued January 9, 2018.

Should you have any questions regarding this matter, please contact Lora Gescheidle at lgescheidle@cenhud.com or (845)486-5822.

Respectfully submitted,

/s/*Paul A. Colbert*

Paul A. Colbert
Associate General Counsel
Regulatory Affairs

284 South Avenue
Poughkeepsie, NY 12601

(845) 452-2000
Phone: (845) 486-5831 Cell: (614) 296-4779
Email: pcolbert@cenhud.com
www.CentralHudson.com

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission on Changes in Law that May Affect Rates.	**Case 17-M-0815**

Comments and Responses to 2017 Tax Cuts and Jobs Act Letter

January 31, 2018

CENTRAL HUDSON GAS & ELECTRIC CORPORATION
284 South Avenue
Poughkeepsie, N.Y. 12601

I. Introduction

On December 22, 2017, the Tax Cuts and Jobs Act (Tax Act) was signed into law. The Tax Act makes significant changes to the federal tax structure, which will impact the tax liabilities of New York's utilities, as well as the associated deferred tax ratemaking. The Tax Act also negatively impacts the cash flows of the utility and without NYS Public Service Commission support, could result in a downgrade in the financial ratings of the utility.

On December 29, 2017, the Commission instituted a proceeding to commence the process of addressing the impact of the Tax Act on the State's utilities and ratepayers. The identified first steps of the process are to solicit information from the utilities to identify and quantify the impact of the Tax Act, schedule a technical conference with the utilities, and issue a Staff proposal within 90 days for treatment of the tax changes, the goal of which will be preserving any net tax benefits for ratepayers.

On January 9, 2018, the Director of the Office of Accounting, Audits and Finance filed the 2017 Tax Cuts and Jobs Act Letter requesting certain utilities to provide responses to the questions in the attachment to the letter by January 31, 2018 in order to facilitate discussion at the upcoming technical conference, assist in the development of the Staff proposal that is expected to address ratemaking issues and alternatives, and assess the impact of the tax revisions contained within the Tax Act.

II. Responses and Comments

A. <u>General</u>

1. ***Identify, and provide a description, of each tax change that is expected to impact the utility company.***
2. ***Provide the date, and rationale, the utility company expects each tax change to become effective for its operations.***

Please refer to Attachment A for a listing of the provisions of the Tax Cuts and Jobs Act that impact Central Hudson, including the effective date as prescribed in the Tax Cuts and Jobs Act.

B. <u>Corporate Tax Rate</u>

1. ***Identify the effects of the tax rate change for the years 2018 and 2019, and provide all calculations and assumptions.***
    a. ***Current federal income tax expense***
    b. ***Deferred federal income tax expense (originating and reversing)***

Central Hudson is only able to quantify the effects on the first six months of 2018, which is based on current rates approved in Case 14-E-0318 and 14-G-0319. The effect of the tax rate change will be incorporated into delivery rates effective July 1, 2018 based on the current rate proceeding under Case 17-E-0459 and 17-G-0460. See Attachment B for the calculation of the effects of the tax rate change on the current and deferred income tax expense for the period of January 1, 2018 through June 30, 2018.

2. ***Identify the effective date of the corporate tax rate change for the utility company, and indicate and explain if the effective date of the change will result in a blended tax rate being used for the first year? If yes, identify the blended rate and show all calculations. If no, explain why there will be no blended rate.***

Please refer to Attachment A for a listing of the provisions of the Tax Cuts and Jobs Act that impact Central Hudson, including the corporate tax rate change and the effective date. As this rate is in effect for the full calendar year, there will not a blended rate for calendar year 2018 with regard to Central Hudson's current tax expense and deferred tax expense for timing differences, excluding deferred taxes associated with Plant-related accelerated deductions. With regard to deferred taxes associated with certain accelerated deductions (protected), new originating timing differences will be recorded at the new corporate tax rate beginning January 1, 2018. However, previously existing timing differences will reverse at the old corporate tax rate in accordance with tax normalization rules. This results in a blended effective tax rate for total income tax expense for the corporation. On a rate year basis, Central Hudson will have a blended rate for the rate year ended June 30, 2018 because the 35% corporate income tax rate would be applicable for the first half of the rate year (July through December 2017) and 21% corporate income tax rate would be applicable for the second half of the rate year (January through June 2018).

C. <u>Excess Deferred Tax Reserve</u>

1. ***As a result of the tax rate change from 35% to 21%, what is the estimate value of the excess accumulated deferred federal income tax (ADFIT) balance as of December 31, 2017? Provide all calculations. Provide the breakdown of the excess ADFIT by:***
   a. ***Accelerated Depreciation (i.e. protected)***
   b. ***Other tax timing differences (unprotected)***

Please refer to Attachment C1 for the journal entries and related calculations of the excess accumulated deferred income tax broken out between protected and unprotected balances.

2. ***As a result of the tax rate change from 35% to 21%, what is the estimate value of the excess ADFIT balance as of December 31, 2018 and December 31, 2019? Provide all calculations. Provide the breakdown of the excess ADFIT by:***
   a. ***Accelerated Depreciation (i.e. protected)***
   b. ***Other tax timing differences (unprotected)***

Please refer to Attachment C2 for a rollforward and estimated values of the protected and unprotected excess accumulated deferred tax balances from December 31, 2017 through December 31, 2018 and 2019.

3. ***For the estimated value of the excess ADFIT balances at 12/31/17 and at 12/31/18:***
   a. ***To be consistent with the Commission's identified goal of preserving the net tax benefits for ratepayers, explain how the Company will account for the excess ADFIT.***
   b. ***Provide the calculation and the specific accounting the Company plans to implement to record and return the excess ADFIT to ratepayers. Identify all assumptions.***
   c. ***Identify and explain any and all restrictions the utility company believes exists on the allowed amortization of the excess ADFIT balances. This includes addressing any timing restrictions.***
   d. ***Identify and explain any and all natural unwinding that would occur of the excess ADFIT balances.***

Please refer to Attachment C1 for the journal entries recorded by Central Hudson at December 31, 2017 to fully defer the amount of the excess accumulated deferred income taxes. The excess accumulated deferred income taxes were grossed up, recorded to a regulatory asset (unprotected) and liability (protected) with applicable deferred taxes recorded on these regulatory balances. The protected regulatory liability will be included in rate base until returned to customers. Act Section 203(e) of the Tax Reform Act of 1986 and Section 13001(d) of the Tax Cuts and Jobs Act specifically states that excess accumulated deferred taxes associated with accelerated depreciation deductions cannot be used to reduce the cost of service more rapidly or to a greater extent than the rate at which the book/tax temporary differences reverse over the life of the property that gave rise to those deferred tax balances. These tax normalization rules ensure that the tax benefits of these accelerated deductions are provided back to customers over the same period that the customer pays for the assets through depreciation in current rates. Central Hudson has included all plant related accelerated deductions in the protected regulatory liability under the similar premise. The calculation of the reversal of the deferred taxes recorded at the old corporate income tax rate (35%), over the life of the assets to which the deferred balances relate, will be performed using Central Hudson's Powertax system using the Average Rate Assumption Method (ARAM). Under such method, as timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying: (1) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by (2) the amount of the timing differences which reverse during such period. Any variation from this amortization would be a violation of tax normalization rules and would result in an increase in tax expense and preclude the company from being able to take advantage of any accelerated deductions in the future, such as Modified Accelerated Cost Recovery System (MACRS) depreciation.

The unprotected regulatory asset will be deferred and included in rate base until the timing of the future recovery from customers is determined in future rate proceedings. As both the protected and unprotected regulatory balances are assumed to be included in rate base, consistent with the treatment of the accumulated deferred tax balances prior to being re-valued, there will be no carrying charges necessary on these balances.

4. ***Regarding normalization:***
    a. ***What is the effect of the normalization rules applicable to the excess ADFIT balances for the years 2018 and 2019. State how the utility will apply the normalization rules to the excess ADFIT balances.***
    b. ***Identify, and provide the rationale, for which method of normalization the utility company employs or will employ, specifically the Average Rate Assumption Method (ARAM) or the Reverse South Georgia Method (RGSM).***
    c. ***Has the utility company maintained sufficient records, i.e. the requisite vintage records, to use the ARAM? If no, explain why not.***

Please refer to Central Hudson's response under C.3 above for the effect of tax normalization rules on the amortization of the protected regulatory liability balances. Central Hudson has maintained sufficient records and uses the ARAM.

D. <u>FAS 109</u>

1. ***As a result of the tax rate change from 35% to 21%, the FAS 109 accounts will need to be revalued.***
    a. ***What will be the effect on FAS 109 accounts balances as of December 31, 2017?***
    b. ***Will the revaluation of the FAS 109 accounts impact operating income? If so, what is the expected dollar impact and the rationale?***
    c. ***Provide the proposed journal entries resulting from the tax rate change with estimated dollar amounts, for the FAS 109 account balances.***

Please refer to Attachment D for the journal entries related to the revaluation of the FAS 109 accounts. This amount has been fully deferred consistent with the prior treatment of any changes in these accounts.

E. <u>Net Operating Loses</u>

1. ***Currently, what is the amount of net operating tax losses available to the utility company?***

As of December 31, 2017, Central Hudson has a Federal net operating tax loss of approximately $11.5 million, which is recorded as a deferred tax asset of $2.4 million.

2. ***How will the changes contained in the Tax Act related to deduction of net operating losses affect the utility company?***

The changes contained in the Tax Cuts and Jobs Act related to the deduction of net operating losses will not affect Central Hudson as the Federal NOL is expected to be fully utilized in 2018 and, with the elimination of bonus depreciation, Central Hudson does not project it will generate any future Federal taxable losses which would be subject to the new limitations under the Tax Cuts and Jobs Act.

F. <u>Bonus Depreciation</u>

1. ***What is the effect on the utility company due to the bonus depreciation changes contained within the Tax Act for the year 2017? The response should at a minimum address cash flow changes, revenue requirement effects/changes, as well any other changes the utility company expects. Provide supporting calculations, and identify all assumptions.***

The elimination of bonus depreciation will result in additional current taxes due and therefore, will negatively impact cash flows. See Attachment F for a calculation of the estimated impacts of the elimination of the bonus depreciation deduction on Central Hudson's estimated taxable income for calendar year 2017 through 2019 and the resulting increase in current taxes due.

There will be no impact on the revenue requirement as Central Hudson's current rates do not include bonus depreciation. Central Hudson has deferred the revenue requirement effects of bonus through September 27, 2017 in accordance with the provisions of Case 14-E-0318 and 14-G-0319. There will be no deferrals for additional bonus depreciation deductions beginning in 2018.

2. ***What is the effect on the utility company due to the bonus depreciation changes contained within the Tax Act for the years 2018 and 2019? The response should at a minimum address cash flow changes, revenue requirement effects/changes, as well any other changes the utility company expects. Provide supporting calculations, and identify all assumptions.***

Please see response to F.1 above and Attachment F1 for a calculation of the estimated impacts of the elimination of the bonus depreciation deduction on Central Hudson's estimated taxable income for calendar year 2017 through 2019 and the resulting increase in current taxes due.

Revenue requirements set in future rate proceedings will be impacted by the elimination of bonus through lower income tax expense, partially offset by higher current tax expense at a lower corporate income tax rate. Additionally, the deferred tax liability balances associated with the bonus depreciation deductions had the effect of reducing rate base. There will be no further deferred tax liabilities recorded for bonus depreciation and therefore, no further reductions to rate base beginning January 1, 2018. As the deferred taxes associated with bonus depreciation deductions taken in prior years, reverse without offsetting increases for additional bonus deductions, Central Hudson's rate base will increase. This will result in an additional offset to the lower tax expense in future revenue requirements for the return on this rate base growth.

3. ***In the utility company's current effective rate plan, are there any provisions that would be applicable, and automatically capture the impacts, of the Tax Act change in the treatment of bonus depreciation? If yes, please explain.***

As noted in response to F.2 above, Central Hudson's current rates do not include bonus depreciation. However, Central Hudson's current rate plan contains a provision for the deferral of the revenue requirement effects of bonus depreciation. Central Hudson was deferring the revenue requirement effects of bonus through 2017. There will be no new deferrals for bonus beginning January 1, 2018.

G. <u>Interest Expense Deduction Limitation</u>

1. ***For ratemaking purposes, does the utility utilize a consolidated or standalone capital structure?***

Central Hudson uses a standalone capital structure.

2. ***Will the limitation of interest deductibility, have any impact on the utility operations, and any revenue requirement impact? If yes, explain in full, and provide the supporting calculations of the various impacts that are expected.***

No, regulated utilities are exempt from the limitation of interest deductibility.

H. <u>Interest Coverage, Cash Flow and Bond Ratings</u>

1. ***Assuming the company's revenues are adjusted to reflect the various tax law changes contained within the Tax Act, what is the expected impact on the utility company's (a) cash flow, (b) interest coverage, and (c) bond ratings for the years 2018 and 2019.***

The impacts of the Tax Cuts and Jobs Act will result in a lower revenue requirement and an increase in current taxes due as the elimination of bonus will result in a higher taxable income which is only partially offset by the lower corporate tax rate. This will have a negative effect on Central Hudson's interest coverage and other key credit ratios. Without the NYS Public Service Commission's support to offset these negative impacts of the Tax Cuts and Jobs Act in the current on-going rate proceeding, Central Hudson expects it will be downgraded.

I. Other Items

1. ***Individually identify any other provision changes contained within the Tax Act, not mentioned above, which will have an impact on the utility company's revenue requirements. Which of the provision changes is expected to have a material impact?***

Please refer to Attachment A for a listing of all the provisions of the Tax Cuts and Jobs Act that impact Central Hudson. The significant provisions impacting Central Hudson have all been addressed above.

2. ***Identify the revenue requirement effects for each of the identified items for each of the years 2018 and 2019. Provide supporting calculations and identify all assumptions.***

   N/A

3. ***For each of the calendar years 2018 and 2019, identify how the utility company will account for the revenue requirement impact of the tax law changes contained within the Tax Act.***

   Central Hudson will defer the revenue requirement effects of the Tax Cuts and Jobs Act through June 30, 2018 and anticipates having the impacts incorporated in current rates effective July 1, 2018 as part of its current rate proceeding.

4. ***In the Commission's December 29, 2017 Order, it identified the goal of reserving the net tax benefits resulting from the changes within the Tax Act for ratepayers. There are various options to provide the benefits to ratepayers, e.g. deferral approach until next rate case, implementation of a sur-credit, implementation in a second stage of a multi-year plan, rate case reopener, offset of other deferrals, etc.***

   What is the utility company's proposal for treatment of the net tax benefits, and how do you propose ratepayers receive this net benefit amount? Explain why this proposed approach is the most optimal.

   Central Hudson's proposal is to defer the revenue requirement effects until the next rate case as Central Hudson is currently in a rate proceeding which will incorporate the impacts of the Tax Cuts and Jobs Act in new rates to be effective July 1, 2018.

5. ***Identify the carrying charge rate that should be utilized pending return of the net tax benefits to customers. Provide the rationale for use of this rate.***

   As noted earlier, Central Hudson proposes that the regulatory balances associated with the excess accumulated deferred tax balances be included in the calculation of rate base and therefore would not accrue carrying charges. If carrying charges were applied, then the balance cannot be included in rate base and the Company would defer the revenue requirement effects of this reduction to rate base, thus resulting in an offsetting carrying charge.

The carrying charge rate that should be applied to the revenue requirement effects of the lower corporate income tax rate and the elimination of bonus depreciation should be based on a newly calculated pretax weighted average cost of capital calculated as the net-of-tax weighted average cost of capital approved in the current rate plan, grossed up by the new corporate income tax rate.