BEFORE THE STATE CORPORATION COMMISSION

OF THE STATE OF KANSAS

DIRECT TESTIMONY

OF

ANDY DEVIN

WESTAR ENERGY

DOCKET NO. 18-WSEE-328-RTS

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Eric A. (“Andy”) Devin, 818 South Kansas Avenue, Topeka, Kansas 66612.

Q. BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?

A. Westar Energy, Inc. (Westar) as Executive Director, Tax & Compliance.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EMPLOYMENT EXPERIENCE.

A. I hold an M.B.A. and a BS in Business and Accounting from the University of Kansas. I am also a Certified Public Accountant. I joined Westar's tax department in 1996 after seven years in public accounting. I rejoined Westar in 2010 in the Benefits Accounting group after six years in senior level accounting and finance positions of another publicly held company. I moved to my current role in November 2013.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?

A. Yes, I submitted testimony to the Commission in a previous rate case.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to discuss the newly passed Tax Cuts and Jobs Act of 2017 (which reduces the revenue requirement in this case by $74 million), the tax exhibits in Section 11 and the tax impact of all accounting adjustments in Westar's Minimum Filing Requirements (MFRs).

III. TAX CUTS AND JOBS ACT OF 2017

Q. ON DECEMBER 22, 2017, PRESIDENT TRUMP SIGNED THE TAX CUTS AND JOBS ACT OF 2017. PLEASE EXPLAIN THE MAJOR COMPONENTS OF THIS NEW LEGISLATION.

A. The primary component of the legislation that will impact Westar is the reduction of the federal tax rate to 21% from 35% effective on January 1, 2018. The Westar MFRs includes an adjustment (see Pro Forma Adjustment No. IS-52 discussion below) to reflect the impact of the new overall income tax rate (including state income taxes) used to compute income tax expense in cost of service from 39.55% to 26.53%. Income tax expense has also been adjusted for an estimated amount of excess deferred income taxes to be amortized back to customers. This amortization represents a portion of the accumulated deferred income taxes previously recovered from customers but not yet paid to the Internal Revenue Service. Since these taxes will no longer need to be paid, they will be given back to customers over an appropriate time period. The majority of the amount to be returned to customers are plant related temporary differences. The estimated annual amount of excess deferred income taxes for plant related temporary differences will be given back to customers using the normalization rules required by the Tax Cuts and Jobs Act. Amortization of excess deferred taxes related to tax net operating losses will be amortized over five years and excess deferred taxes for non-plant related temporary differences will be amortized over ten years.

IV. PRO FORMA TAX ADJUSTMENTS

Q. WILL EACH OF THE PRO FORMA REVENUE AND EXPENSE ADJUSTMENTS IN SECTION 9 AFFECT INCOME TAXES?

A. Yes. All of the pro forma revenue and expense adjustments summarized on Schedules 9-A and individually identified and explained throughout Sections 9, 10 and 11, affect the income tax component in cost of service.

The income tax component includes current income taxes, deferred income taxes and the amortization of investment tax credits. Current income taxes represent the taxes currently payable to the federal and state governments. Deferred income taxes are taxes reported currently, but payable to the federal and state governments at some future date. The amortization of investment tax credits represents a pro rata portion of the tax credits that are flowed through to customers over the lives of the related properties.

Q. WILL EACH OF THE PRO FORMA REVENUE AND EXPENSE ADJUSTMENTS AFFECT CURRENT AND DEFERRED INCOME TAXES?

A. No. Most of the pro forma revenue and expense adjustments will not affect deferred income taxes. Only the pro forma adjustments to depreciation and amortization expense (hereinafter referred to as depreciation expense) will affect deferred income taxes.

Q. PLEASE EXPLAIN.

A. While the pro forma adjustments for depreciation expense affect Westar's depreciation expense in cost of service, this depreciation expense is not used to calculate tax expense in cost of service. Rather, Westar uses accelerated tax depreciation to calculate its current tax expense in cost of service and tax straight-line depreciation as the basis for calculating deferred income tax expense in cost of service and in financial statements. Deferred income taxes are provided on the difference between the accelerated tax depreciation and the tax straight-line depreciation. What this means is that for ratemaking purposes, income taxes are determined based on tax straight-line depreciation even though the amount of income taxes actually paid by Westar during the test year was based on accelerated tax depreciation. Westar maintains a reserve to reflect the difference between the taxes paid to the Internal Revenue Service and the taxes allowed in rates or reported in financial statements. The deferred tax reserve is deducted from rate base.

Q. IS IT UNUSUAL FOR A UTILITY TO HAVE TAX TIMING DIFFERENCES BETWEEN ITS ACTUAL TAX PAYMENTS AND TAXES REFLECTED IN RATES?

A. No. In fact, it is a natural consequence of the use of accelerated depreciation for determination of taxes payable to the government and straight-line depreciation for ratemaking.

Q. HAS WESTAR BEEN ABLE TO TAKE ADVANTAGE OF BONUS DEPRECIATION AND IS IT REFLECTED IN WESTAR'S MFRS?

A. Yes, on both counts. In December 2015, Congress passed and the President signed into law the "Protecting Americans from Tax Hikes (PATH) Act of 2015" which, among other things, extended bonus depreciation for an additional five-year period encompassing the years 2015 through 2019 (note that the new Tax Cuts and Jobs Act of 2017, generally ends bonus depreciation for regulated utilities for assets placed in service after September 27, 2017). Bonus depreciation has been available nearly every year since 2001 and typically has allowed for a 50% deduction of basis in the year certain assets are placed in service. We have historically taken advantage of bonus depreciation deductions when available resulting in a continuing series of net operating tax losses (NOLs) for federal income tax purposes and in states that allow bonus depreciation. Because we have been in an NOL position, we have been limited in our ability to utilize tax credits, both at the federal and state levels. In some cases, these credits were earned in 2000 and 2001 and will begin expiring in 2020. In our 2015 Form 10-K filing, we stated,

> As a result of the five-year extension in 2015, should we continue to fully utilize the depreciation deductions under bonus depreciation certain tax credits provided by the State of Kansas related to investments in utility plant may not be realizable requiring us to record a valuation allowance. At this time, we expect to utilize bonus depreciation to the extent necessary to fully utilize the aforementioned Kansas tax credits.

We did not take full advantage of bonus depreciation in our 2015 and 2016 consolidated federal income tax returns because it was more advantageous for us to use production tax credits and state tax credits with expiration dates over using bonus depreciation. In essence, we opted out of a temporary tax “timing” difference in order to preserve a permanent tax benefit. We currently have over $150 million in unused federal tax credits and over $220 million in unused state tax credits which could be at risk if we continued to take full advantage of bonus depreciation.

Because Westar Energy, Inc. remains in a NOL tax position as of June 30, 2017, there is no net impact to rate base. This is due to the fact that the increase to the ADIT Liability for Plant in Service would have been fully offset by an increase in the ADIT Asset for the increase in the net operating loss carryforward. Absent further tax law changes, we expect to remain in a NOL tax position into 2020.

Bonus depreciation in the amount of $319,567,609 was recorded by Westar during the test year and the appropriate amount of accumulated deferred income taxes has been removed from the rate base in the Application, consistent with past regulatory practice.

Q. ARE THE DEFERRED INCOME TAXES RELATED TO DEPRECIATION DIFFICULT TO COMPUTE?

A. Yes. The calculation of the depreciation-related deferred income taxes is complex and data intensive and we utilize Westar's existing computerized tax accounting system and database to perform the calculation.

Q. PLEASE EXPLAIN THE PRO FORMA ADJUSTMENTS IN SECTION 9 OF WESTAR'S MFRS THAT AFFECT DEFERRED INCOME TAXES.

A. Adjustment No. IS-23 in Westar's MFRs is sponsored by Mr. Kongs and reflects the Commission's adoption of Staff's adjustment to decrease the rate base for a portion of the accumulated deferred income tax expense related to the recoverable acquisition premium and to amortize the accumulated deferred income tax to income over a remaining life of 34.83 years. This adjustment decreases Westar's current income taxes by $6,782,761 and deferred income taxes by $2,382,587.

Q. PLEASE EXPLAIN PRO FORMA ADJUSTMENT NO. IS-7 DEPRECIATION STUDY.

A. Adjustment No. IS-7 in Westar's MFRs reflects the tax effect of the proposed depreciation rates sponsored by Westar witness Dr. White. This adjustment annualizes the tax straight-line depreciation for pro forma test year-end plant in service by applying Dr. White's proposed depreciation rates to each vintage year's tax depreciable basis of property. This tax straight-line amount was then compared to the annualized tax straight-line depreciation amount using the KCC-approved depreciation rates for Westar to determine the pro forma adjustment and its tax effect. This adjustment decreases Westar's deferred income taxes by $12,968,774.

Q. WILL USE OF DR. WHITE'S PROPOSED DEPRECIATION RATES AFFECT THE AMORTIZATION OF INVESTMENT TAX CREDITS?

A. Yes. The use of Dr. White's proposed depreciation rates will change the useful life of property that generated the investment tax credit. Accordingly, Adjustment No. IS-7 adjusts the amortization of investment tax credits to recognize the change in useful life in the first year the rates are effective. The useful life of the property was determined without the inclusion of net salvage amounts in accordance with the Commission's Order in Docket No. 05-WSEE-981-RTS on the proper treatment of the amortization of investment tax credits.

Q. PLEASE EXPLAIN PRO FORMA ADJUSTMENT NO. IS-24 ANNUALIZED DEPRECIATION.

A. Adjustment No. IS-24 in Westar's MFRs annualizes the accelerated tax depreciation, including bonus depreciation, and the tax straight-line depreciation for pro forma test year-end plant in service. The annualized accelerated tax depreciation and tax straight-line depreciation was computed by applying the appropriate tax depreciation rates, or the KCC-approved depreciation rates, for Westar to each vintage year's tax depreciable basis of property. The annualized amounts were then compared to the accelerated tax depreciation and tax straight-line depreciation amounts in the test year to determine the pro forma adjustments and their tax effects. The existing depreciation rates were approved by the KCC in Docket No. 12-WSEE-112-RTS. The adjustment increases Westar's current income tax by $12,068,247 and decreases deferred income tax by $26,338,368.

Q. PLEASE EXPLAIN PRO FORMA ADJUSTMENT NO. IS-46 RELATED TO PRODUCTION TAX CREDITS.

A. Adjustment No. IS-46 in Westar's MFRs is sponsored by Mr. Bridson. The Step 1 adjustment reflects the difference between the estimated annualized production tax credits to be generated by the Western Plains wind farm which was placed in service in February 2017 and the production tax credits earned during the test year ended June 30, 2017. This adjustment decreases Westar's deferred income taxes by $16,134,756. The Step 2 adjustment reflects the loss of production tax credits generated by the Flat Ridge and Central Plains wind farms earned during the test year ended June 30, 2017 resulting in an increase to deferred income tax of $9,770,859. The total adjustment is a net decrease to Westar's deferred income taxes of $6,363,897.

Q. PLEASE EXPLAIN PRO FORMA ADJUSTMENT NO. IS-47 RELATED TO INTEREST SYNCHRONIZATION.

A. Adjustment No. IS-47 in Westar's MFRs synchronizes test year interest expense used in computing taxable income with the rate base. These amounts were determined by applying the weighted cost of debt for Westar to the adjusted rate base at the end of the test year. The net effect of this adjustment for Step 1 is to increase current income taxes by $9,016,528 and the adjustment for Step 2 is an additional increase of $58,125 for total increase of $9,074,653.

Q. PLEASE EXPLAIN PRO FORMA ADJUSTMENT NO. IS-48 DESIGNATED AS TAX ELIMINATION ADJUSTMENT.

A. This adjustment is necessary to correct the test year calculation of income taxes for Westar. Specifically, the adjustment eliminates the effects of (1) tax reserves for uncertain tax positions related to income taxes, (2) the Texas margin tax and Oklahoma income tax, (3) the compensation deduction for restricted share units charged to paid-in capital, (4) using the estimated annual effective tax rate method to account for income taxes in interim financial periods, and (5) utilizing the combined income method of reporting income on Westar's Kansas corporate income tax return. The net effect of these adjustments decreases operating income for Westar by $4,224,954.

Q. PLEASE EXPLAIN PRO FORMA ADJUSTMENT NO. IS-49 RELATED TO PRIOR YEAR ADJUSTMENTS.

A. Prior year adjustments reflect the differences between the estimated amounts recorded on the books and the actual amounts reported in the filed income tax returns. The prior year adjustments are recorded on the books after the income tax returns are filed. These adjustments eliminate the impact of the prior year tax adjustments recorded on the books of Westar during the test year. These adjustments decrease operating income for Westar by $2,060,195.

Q. PLEASE EXPLAIN PRO FORMA ADJUSTMENT No. IS-52 RELATED TO THE TAX RATE CHANGE.

A. As discussed above, on December 22, 2017, President Trump signed the Tax Cuts and Jobs Act of 2017 which, among other things, reduced the corporate federal income tax rate to 21% from 35% effective January 1, 2018. Accordingly, Adjustment No. IS-52 in Westar's MFRs reflects the reduction in the test year income tax expense from the reduced federal tax rate and from the estimated amount of amortization of the excess accumulated deferred income taxes. The decrease to test year income tax expense is $54,205,243.

Q. WILL THE ELIMINATION ADJUSTMENTS IN SECTION 9 OF WESTAR'S MFRS AFFECT INCOME TAXES?

A. Yes. All of the elimination adjustments summarized on Schedules 9-A and individually identified and explained on Schedules 9-C and 9-D affect income taxes. These adjustments eliminate from the calculation of the income tax component in cost of service the effects of (1) the Retail Energy Cost Adjustment and (2) transmission income and expenses. Collectively, these adjustments decrease Westar's income taxes in Step 1 by $57,250,678 and an additional $10,996 in Step 2 for a total decrease of $57,261,674.

V. SECTION 11 OF THE MFRS

Q. WOULD YOU PLEASE DESCRIBE SECTION 11 OF WESTAR'S MFRS.

A. This section contains the supporting schedules for the test year provisions, eliminating entries and pro forma adjustments for taxes chargeable to Westar's electric operations and are shown on Schedule 9-A, Lines 16 and 18 through 20. Each of the schedules in Section 11 was based on Westar's book and tax accounting records for the twelve months ended June 30, 2017.

Q. PLEASE DESCRIBE THE SCHEDULES INCLUDED IN SECTION 11 OF WESTAR'S MFRS.

A. Schedules 11-A present the taxes chargeable to Westar's electric operations for the test year ended June 30, 2017. This schedule shows book taxes, eliminating entries, pro forma adjustments, and pro forma adjusted taxes. Pro forma adjusted taxes for Step 1 is $179,088,488, reduced in Step 2 by $1,244,359 for a balance of $177,844,129. Appropriate support for each of the taxes is found on succeeding schedules.

Q. PLEASE DESCRIBE THE DIFFERENT KINDS OF TAXES CHARGEABLE TO WESTAR'S ELECTRIC OPERATIONS.

A. Taxes chargeable to Westar's electric operations include taxes of all types – taxes other than income taxes and income taxes.

Q. PLEASE DESCRIBE SCHEDULE 11-B.

A. Schedule 11-B is a summary of the taxes other than income taxes that are chargeable to Westar's electric operations for the test year. Taxes other than income taxes consist of federal and state payroll taxes, real estate and personal property taxes, and other taxes. Payroll taxes include Social Security and Medicare taxes, federal unemployment tax, state unemployment tax, and worker's compensation. Other taxes include corporate franchise taxes. The pro forma adjustment to payroll is sponsored by Ms. Dick.

Pro forma adjusted taxes other than income taxes are $135,457,939, compared to $177,256,677 for the test year ended June 30, 2017.

Q. WHAT IS THE PURPOSE OF SCHEDULES 11-C THROUGH 11-G?

A. Schedules 11-C through 11-G detail the calculation of the income taxes included in cost of service for Westar's electric operations.

Q. WHAT IS SHOWN ON SCHEDULES 11-C THROUGH 11-E?

A. Schedule 11-C is the derivation of taxable income for Westar's electric operations for the test year ended June 30, 2017. The schedule shows the differences between revenues and expenses recognized for book purposes and those recognized for income tax purposes. The differences are referred to as book-tax differences and generally originate in one period and reverse or turn around in one or more subsequent periods. The reported differences are individually described on Schedule 11-D, and reflect the past tax practices of Westar. Taxable income has been adjusted to a level consistent with pro forma revenues, expenses, and book-tax differences for the test year. Pro forma adjusted taxable income for the test year for Step 1 is a net loss of $13,259,705, with an additional loss in Step 2 of $39,462,241 for total loss of $52,721,946. The net loss is attributable to the use of bonus depreciation, as discussed earlier in my testimony.

Schedule 11-E shows the calculation of state and federal current income taxes for Westar's electric operations. Pro forma adjusted current income taxes for the test year for Step 1 and Step 2 are $20,630,426 and $9,615,208, respectively.

Q. PLEASE DESCRIBE SCHEDULE 11-F.

A. Schedule 11-F is the provision for deferred income taxes and investment tax credits for Westar's electric operations for the test year ended June 30, 2017. Deferred income taxes have been adjusted to reflect the level of book-tax differences in the test year. Pro forma adjusted deferred income taxes for the test year for Step 1 and Step 2 are $25,040,339 and $34,811,198, respectively. Pro forma investment tax credits are a negative $2,040,217.

Q. PLEASE DESCRIBE SCHEDULE 11-G.

A. Schedule 11-G is the total income tax provision for Westar's electric operations for the test year ended June 30, 2017. Total income taxes equal the sum of current income taxes and deferred taxes, including investment tax credits. Total income taxes are calculated by multiplying the pretax income as adjusted for book-tax differences for which no deferred income taxes have been provided by the composite income tax rate. Pro forma adjusted total income taxes for the test year for Step 1 is $46,960,190, reduced in Step 2 by $1,244,360 for a balance of $45,715,830.

Q. PLEASE DESCRIBE SCHEDULE 11-H AND 11-I.

A. Schedule 11-H displays the accumulated deferred income taxes for Westar for the period beginning January 1, 1992 through June 30, 2017. The accumulated deferred income taxes include accounts 190, 281, 282, and 283, excluding the impact of SFAS 109. The schedule shows amounts deferred, credited to income, adjustments, and the accumulated balance for each year.

Schedule 11-I shows the accumulated federal and state investment tax credits for Westar for the period beginning January 1, 1992 through June 30, 2017. The schedule displays amounts deferred, credited to income, and the accumulated balance for each year.

Q. THANK YOU.