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**PREFILED DIRECT TESTIMONY
OF WAYNE M. HITT
ON BEHALF OF NORTHWESTERN ENERGY**

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Witness Information

- Q. Please state your name and business address.**
- A.** My name is Wayne M. Hitt. My business address is NorthWestern Energy, 3010 West 69th Street, Sioux Falls, South Dakota 57108.
- Q. By whom are you employed and in what capacity?**
- A.** My present position is Director–Corporate Taxes with NorthWestern Energy (“NorthWestern” or “NWE”).
- Q. Please describe your education and business experience.**
- A.** I graduated from Southern Illinois University in 1980 with a Bachelor’s

1 Degree in Business Administration with a major in Accounting. I am a
2 Certified Public Accountant in California. I have been Director–Corporate
3 Taxes at NWE since January 1, 2008. Before joining NWE, I served NWE as
4 an independent consultant functioning as the Manager-Income Tax for
5 approximately 4 1/2 years. Previous to my involvement with NWE, I was
6 Director-Corporate Taxes for Sempra Energy and subsidiaries, which
7 includes San Diego Gas & Electric Company and Southern California Gas
8 Company, for 3 years. Additionally, I was Manager-Corporate Taxes & held
9 other various positions for Sempra Energy and subsidiaries for a total of
10 approximately 12 years. I have over 28 years of experience in the field of
11 corporate taxation with over 20 years related to regulated public utility
12 companies. I have testified before the California Public Utilities Commission
13 on several occasions related to utility income taxes and property taxes. I
14 have testified before the Federal Energy Regulatory Commission (“FERC”)
15 related to utility income taxes and property taxes. I have previously testified
16 before the Montana Public Service Commission (“Commission”) regarding
17 the joint stipulation between NWE and the Montana Consumer Counsel
18 (“MCC”) related to NorthWestern Energy’s Application for Approval for
19 Authority to Establish Increased Natural Gas and Electric Delivery Service
20 Rates, Docket No. D2007.7.82, and regarding the Colstrip Unit #4
21 proceeding in Docket No. D2008.6.69.
22

23 **Q. What are your responsibilities as Director- Corporate Taxes?**

24 **A.** I am responsible for all tax related compliance, research and planning
25 activities for NWE.
26

27 **Purpose of Testimony**

28 **Q. What is the purpose of your testimony?**

29 **A.** The purpose of my testimony is to support all income and property tax
30 related items included in this filing. All income and property tax items in the
31 natural gas and electric income statements and rate base exhibits were
32 prepared under my supervision and control.

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Q. Have income taxes in this filing been calculated in a manner consistent with the methodology approved by the Commission in prior rate proceedings?

A. Yes. The income taxes included in this filing have been calculated utilizing the partial flow-through method that the Commission has approved in prior dockets. Plant-related tax adjustments have always been flowed through to customers, except for those subject to mandatory normalization under Section 168 of the Internal Revenue Code ("IRC"). On September 25, 2009, NorthWestern received a Consent Letter from the Internal Revenue Service ("IRS") in response to NWE's request to change its method of accounting for income tax purposes related to how deductible repair expenses are calculated effective for the tax year 2008. This consent will allow NWE to analyze its capital expenditures on the books annually and deem a significant portion of those expenditures as deductible ordinary and necessary business repair expenses in the year they are incurred under Section 162 of the IRC. In accordance with past orders of the Commission and other plant-related tax adjustments, most recently by the Montana Power Company in Final Order No. 5709d of Docket No. 93.6.24, NWE has flowed through these tax deductions, including the results of the recent IRS consent, for the benefit of retail customers in this filing. Accordingly, the amount of repair deductions included in this filing net of requisite FIN 48 reserve can be seen on Statement J, Workpapers – B (Electric – Page 10; Natural Gas – Page 7).

Natural Gas and Electric - Deferred Income Taxes

Q. Please explain all of the provisions for deferred income taxes.

A. The detail of the deferred income taxes is shown in Statement J workpapers. I describe below the deferrals shown in that statement:

Injuries and Damages Accrued Net of Paid

NorthWestern accounts for personal injuries and damages for book

1 purposes under the accrual method based upon actuarial studies. For
2 income tax purposes, these expenses are deducted as paid. Deferred
3 income taxes have been provided to account for the temporary difference.
4 Rate base has been adjusted for the accumulated deferrals.

5
6 **Property Taxes Accrued Net of Paid**

7 NorthWestern accounts for property taxes for book purposes under the
8 accrual method based upon the taxing authorities' assessed values and bills
9 remitted. For income tax purposes, these expenses are deducted as paid.
10 Deferred taxes have been provided to account for the temporary difference.
11 Rate base has been adjusted for the accumulated deferrals.

12
13 **Incentive Pay Accrued Net of Paid**

14 NorthWestern utilizes incentive pay plans for all employees as part of its
15 compensation package. The costs of these plans is accrued in the current
16 year but not paid until March of the following year. The accrual done at year
17 end is an estimate of what will be paid by March 15th the following year.
18 Compensation not paid within 2½ months of the end of the year is not
19 deductible on an accrual basis for income tax purposes. This item typically
20 consists of two adjustments. First is the reversal of the previous year's book
21 to tax difference between what was accrued for the books vs. the amount
22 paid by March 15th the following year. Second .is the current year's book to
23 tax difference between what was accrued for the books vs. the amount paid
24 by March 15th the following year. Deferred taxes have been provided to
25 account for the temporary difference. Rate base has been adjusted for the
26 accumulated deferrals.

27
28 **Accelerated Depreciation**

29 This amount is the annual deferred income tax that results from the use of
30 accelerated tax depreciation. The deferral is driven by the tax effect of the
31 difference between accelerated tax depreciation claimed on the tax return
32 and normalized tax depreciation computed using book lives and book

1 methods applied to the tax basis of assets in accordance to the
2 normalization requirements of the Internal Revenue Code. The Internal
3 Revenue Code and regulations require that deferred taxes be calculated in
4 this manner pursuant to normalization requirements in order for NWE to
5 remain qualified to use accelerated methods of tax depreciation on its
6 federal tax return. Rate base has been adjusted for the accumulated
7 deferrals.

8 9 **Contributions In Aid of Construction**

10 When NorthWestern collects a Contribution in Aid of Construction ("CIAC")
11 or a Customer Advance for Construction ("CAC"), the amount collected is
12 taxable income to NorthWestern. In Order No. 5236c in Docket No.
13 86.11.62, the Commission determined that general customers should not
14 bear the costs associated with the taxability of CIAC and CAC. To recover
15 the costs associated with the current tax liability related to receipt of CIAC
16 and CAC which is subsequently recovered through tax depreciation
17 deductions in future years, NorthWestern is allowed to collect a carrying
18 charge from the party requesting the extension of service facilities. The
19 deferred taxes related to CIAC and CAC serve to offset the current taxes
20 related to CIAC and CAC to insure that customers are not charged for
21 amounts for which they are not responsible. Rate base has been adjusted
22 for the accumulated deferrals.

23 24 **Financial Accounting Standards (FAS) 106 & 112 Post Retirement &** 25 **Employment Benefits and Pension Benefits Accrued Net of Paid**

26 NorthWestern accounts for post-retirement and post-employment healthcare
27 and pension benefits under the accrual method. For income tax purposes,
28 these expenses are deducted as paid. Deferred taxes have been provided to
29 account for the temporary difference. Rate base has been adjusted for the
30 accumulated deferrals.

31 **Regulatory Asset- Unamortized Loss On Debt**

32 Northwestern accounts for losses related to the repurchase of its old debt by

1 amortizing those losses over the term of the new debt. For income tax
2 purposes, these losses are deducted in the year incurred. Deferred taxes
3 have been provided to account for the temporary difference. Rate base has
4 been adjusted for the accumulated deferrals.

5
6 **Deferred Revenue**

7 NorthWestern defers for book purposes certain revenues related to
8 transmission reservations or access feasibility studies. For income tax
9 purposes, these revenues are recognized when they are received. Deferred
10 taxes have been provided to account for this temporary difference. Rate
11 base has been adjusted for the accumulated deferrals.

12
13 **Natural Gas – Computation of Current Income Taxes**

14 **Q. Please explain Income Taxes – Federal and Income Taxes – Other**
15 **shown on lines 34 and 35 of Exhibit__(PJD-1) of the Prefiled Direct**
16 **Testimony of Patrick J. DiFronzo (“DiFronzo Testimony”).**

17 **A.** The computations of the Federal Income, Canadian Income and Montana
18 Corporation License Taxes including explanation of the adjustments
19 necessary to determine the test period taxes are shown on Statement J
20 Workpaper B.

21
22 **Electric – Computation of Current Income Taxes**

23 **Q. Please explain Income Taxes – Federal and Income Taxes – Other**
24 **shown on lines 31 and 32 of Exhibit__(PJD-3) of the DiFronzo**
25 **Testimony.**

26 **A.** The computations of the Federal Income and Montana Corporation License
27 Taxes including explanation of the adjustments necessary to determine the
28 test period taxes are shown on Statement J Workpaper B.

Property Taxes Adjustment

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Q. Please explain the amount included on page 2, Column K, of Exhibit__ (PJD-1) of the DiFronzo Testimony and page 2, Column M, of Exhibit__ (PJD-3) of the DiFronzo Testimony, as an adjustment of property taxes.

A. The adjustment consists of two items. First, the 2008 actual property taxes included in the natural gas and electric filings have been adjusted to include 2008 net plant additions. The actual cost to market factor for 2009 was used to arrive at appraised value for the various classes of property. Estimated mill levies were used to calculate tax expense. The mill levies will be adjusted at the time NorthWestern files its rebuttal testimony in this proceeding to reflect changes that will be known at that time, which is consistent with prior MPSC practice. Second, the 2008 actual property taxes included in the natural gas and electric filings have been adjusted to exclude the refunds of property taxes received pursuant to the settlement of protested taxes between the Montana Department of Revenue and NorthWestern related to the years 2005 through 2007. Page 3 of Statement K summarizes the property taxes included in this filing.

Q. Does this complete your testimony?

A. Yes.