STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

In the Matter of the Petition of
Public Service Electric and Gas Company
for Approval of an Increase in Electric and Gas
Rates and for Changes in the Tariffs for
Electric and Gas Service, B.P.U.N.J.
No. 17 Electric and B.P.U.N.J. No. 17
Gas, and for Changes in Depreciation Rates,
Pursuant to N.J.S.A. 48:2-18,
N.J.S.A. 48:2-21 and N.J.S.A. 48:2-21.1, and
for Other Appropriate Relief

BPU Docket Nos. ER23120924 and GR23120925

DIRECT TESTIMONY
OF
CLIFFORD PARDO
12+0 UPDATE

VICE-PRESIDENT OF TAX AND ASSISTANT
CONTROLLER

July 15, 2024
P-4 R-2

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Direct Testimony
Of
Clifford Pardo
Vice-President of Tax and Assistant Controller
PSEG Services Corporation

I. <u>INTRODUCTION</u>

Q. Please state your name and business address.

A. My name is Clifford Pardo. My business address is 80 Park Plaza, Newark, New Jersey.

Q. By whom are you employed and in what capacity?

A. I am employed by PSEG Services Corporation as Vice-President of Tax and Assistant Controller. My professional credentials are attached as Schedule CP-1.

Q. What is the purpose of your testimony?

A. In this proceeding, I am testifying on behalf of Public Service Electric and Gas Company ("PSE&G," "Public Service," or "the Company"). The purpose of my testimony is to present and support tax expense, accumulated deferred income taxes ("ADIT"), modifications to the existing Tax Adjustment Credit ("TAC"), the consolidated tax ratemaking adjustment, and other tax issues arising in this proceeding. Specifically, my testimony is comprised of the following sections:

- Section I provides an introduction;
- Section II summarizes the impacts of the 2017 Tax Cuts and Jobs Act ("TCJA") and 2022 Inflation Reduction Act ("IRA"), and their impacts on this rate proceeding;
- Section III presents current and deferred tax expense and ADIT included in this test period;
- Section IV discusses modifications to the TAC; and

- Section V provides the consolidated tax ratemaking adjustment and presents a computation of that adjustment.

Q. Do you sponsor any schedules as part of your prepared testimony?

A. Yes. I sponsor the following schedules that were prepared or compiled under my direct supervision:

- Schedule CP-1 describes my professional qualifications and business experience;
- Schedule CP-2 R-2 details the computation of income tax expense for electric and gas for the test year;
- Schedule CP-3 R-2 details the computation of accumulated deferred income taxes for electric and gas for the test year;
- Schedule CP-4 R-1 details the computation of the estimated annual net Mixed Service Deduction and the Historic Mixed Service ADIT balance; and
- Confidential Schedule CP-5 R-1 details the computation of the CTA.

II. <u>IMPACT OF TCJA AND IRA</u>

A) TCJA

Q. Does TCJA have implications for this proceeding?

A. Yes. On December 22, 2017, the President signed into law a bill entitled "To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018", more commonly known as the "Tax Cuts and Jobs Act" or "TCJA." Below I describe the major provisions of TCJA and discuss their impacts on this proceeding.

Q. Please describe the implications to PSE&G of the reduction in the federal corporate income tax rate.

A. Effective January 1, 2018 the TCJA reduced the federal corporate income tax rate from 35% to 21%. This rate change had a number of implications, including:

- Reducing PSE&G's tax expense after 2017;
- Increasing PSE&G's operating income by lowering tax expense;
- Creating a portion of PSE&G's 2017 ADIT balance in excess of what is needed to offset future tax liabilities (excess deferred income taxes or "EDIT"); and
- Altering the after-tax cost of debt as well as the revenue gross-up factor and the interest synchronization computation.

Q. What are deferred income taxes and how do they impact customers?

A. PSE&G, through the ratemaking process, charges customers current and deferred income tax expense. Current tax expense represents the tax expense expected to be paid to the government for that tax year. Deferred tax expense represents a future tax liability that will be paid when related temporary differences between book and taxable income reverse.

Q. Can you provide an example?

A. An example of such a temporary difference is the difference created by accelerated depreciation. In the case of accelerated depreciation, deductible tax depreciation exceeds book depreciation in the early portion of an asset's life, but then in the later portion of that asset's life, book depreciation exceeds tax depreciation. In total, the amount of depreciation is the same; just the timing is different. Deferred taxes spread the tax benefit of depreciation over the book life of the property, so that every dollar of book depreciation charged to customers carries a tax benefit. This deferred tax also reduces rate base so that customers receive the benefit of the cost-free capital.

Q. How did the TCJA create excess deferred income taxes?

A. Deferred taxes are calculated using the tax rate in effect at the time the deduction is claimed. TCJA was enacted in 2017 and reduced that tax rate from 35% to 21% starting in 2018. Because the tax rate has permanently declined to 21%, when those timing differences reverse, the amount of tax owed will be computed at the new lower 21% rate, not 35%. As a result, a portion of PSE&G's December 31, 2017 ADIT balance was in excess of what is needed to offset future tax liabilities and thus must be returned to customers.

Q. Are there requirements on how the EDIT is returned to customers?

A. Yes, depending on the deduction that caused the ADIT balance. These excess deferred taxes fall into two categories: (1) those restricted by the normalization provisions of the TCJA (sometimes referred to as "protected" EDIT); and (2) those that are not (sometimes referred to as "unprotected" EDIT).

Q. How is the protected EDIT returned to customers?

A. The protected excess deferred taxes must be returned to customers using the Average Rate Assumption Method ("ARAM"). The ARAM provision provides for the reversal of EDIT on a vintage and class basis as the related timing differences reverse, using the weighted average tax rate at which deferred taxes were established.

Q. How is the unprotected EDIT returned to customers?

A. By way of contrast to the protected EDIT, the unprotected excess deferred taxes can be returned to customers over any reasonable period. As approved by the Board on October 29, 2018 at the conclusion of the Company's prior rate case, the Company has been refunding unprotected EDIT over an approximately five-year period through December 31, 2023[1], with a slight remaining balance to be refunded in 2024, in accordance with the IRS Private Letter Ruling ("PLR") discussed below.

Q. How does TCJA address accelerated and "bonus" depreciation?

A. While TCJA provides for 100% depreciation for capital expenditures beginning September 27, 2017, regulated utilities are not eligible for this 100% expensing. Beginning in 2018, only regular Modified Accelerated Cost Recovery System ("MACRS") depreciation may be claimed by regulated utilities.

Q. Does TCJA contain any other changes relevant to this case?

A. No.

B) IRA

Q. Does the Inflation Reduction Act of 2022 impact the current rate proceeding?

A. The IRA enacted a new 15% corporate alternative minimum tax ("CAMT") and made material changes to energy tax credit law. Since enactment, the U.S. Treasury has issued various proposed regulations and Notices that provide interim guidance regarding several provisions of the IRA. The foundation of the CAMT is U.S. GAAP income: the computation starts with net book income to which IRS prescribed adjustments are made. This is referred to

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[1] *I/M/O the Petition of Public Service Electric and Gas Company for Approval of an Increase in Electric and Gas Rates and for Changes in Tariffs for Electric and Gas Service, B.P.U.N.J. No. 16 Electric and B.P.U.N.J. No. 16 Gas, and for Changes in Depreciation Rates, Pursuant to N.J.S.A. 48:2-18, N.J.S.A 48:2-21 and N.J.S.A. 48:2-21.1, and for Other Appropriate Relief*, BPU Docket Nos. ER18010029 & GR18010030; *I/M/O the New Jersey Board of Public Utilities' Consideration of the Tax Cuts and Jobs Act of 2017*; BPU Docket No. AX18010001; *I/M/O Public Service Electric and Gas Company for Approval of Revised Rates (Effective on an Interim Basis April 1, 2018) to Reflect the Reduction Under the Tax Cuts and Jobs Act of 2017*, BPU Docket No. ER18030231, Decision and Order Adopting Initial Decision and Stipulation (October 29, 2018) (the "2018 Rate Case Order") at 9-11.

as adjusted financial statement income ("AFSI"). Companies whose three-year historical average AFSI exceeds $1 billion is subject to CAMT from that point forward. In any given year a company will pay the IRS the higher of the CAMT or regular tax. The Notices related to the CAMT state that Treasury anticipates issuing additional guidance along with proposed and final regulations. Many aspects of the IRA remain unclear and in need of further guidance; therefore, the impact the IRA will have on PSE&G's financial statements and this proceeding is subject to continued evaluation and the issuance of additional authoritative guidance.

Q. Does the Company believe PSE&G will be subject to the CAMT?

A. Yes, based on the guidance U.S. Treasury has released through Q1, 2024. However, this could change based on the issuance of additional authoritative guidance or interpretation of existing guidance. Based on the understanding as of Q1, 2024, the Company calculated a CAMT liability for 2023 of $55,294,627 for the electric utility and $50,622,621 for gas distribution, or a total for PSE&G of $105,917,248. For clarity, these amounts represent the amount by which the CAMT liability exceeds the regular tax liability. See the revised response to RCR-A-0087 UPDATE for the calculation of the CAMT for the utility. This calculation was not part of the Company's initial filing but was recorded in PSE&G's audited books and recorded in December 2023.

Q. What is the impact of the CAMT on income tax expense?

A. There is no change to PSE&G's income tax expense and cost of service as a result of the CAMT. The CAMT amounts noted above increase current tax expense but are fully offset by a reduction in deferred taxes with no net change to total income tax expense. However, the reduction in deferred taxes results in a decrease in accumulated deferred income taxes and increase in the Company's rate base.

Q. Is the Company seeking recovery of the CAMT in this proceeding?

A. Due to the uncertainty of the rules, not at this time. The Company is still awaiting additional guidance that could increase, decrease or eliminate the CAMT liability for PSE&G. Rather, the Company is proposing to recover any impact of the CAMT through the TAC, once the final rules are clearer, as described in more detail in the testimony of Company Witness Stephen Swetz. There is no impact from the CAMT in the Company's ADIT balance or income tax expense used to set base rates in this proceeding. Further, while Mr. Swetz has adjusted the TAC schedules to allow for recovery on the working capital impact of any CAMT payments, the Company is not including any amount of the CAMT at this time while it awaits additional guidance on the rules.

III. TAX EXPENSE AND ACCUMULATED DEFERRED INCOME TAXES

Q. Have you determined the appropriate income tax expense component of operating income for the filed test period?

A. Yes. I have computed a total income tax expense for the test period of $16 million for electric and a total income tax benefit of ($35) million for gas. This is comprised of a current tax expense of $45 million for electric and a current tax expense of $12 million for gas, and a deferred tax benefit of ($29) million for electric and a deferred tax benefit of ($47) million for gas. The details of this determination are shown on Schedule CP-2 R-2, which shows current tax expense and significant components of deferred tax expense. I provided this tax expense to Mr. McFadden for inclusion in his Schedule MPM–28 R-2. The income tax expense includes a tax benefit for bad debt write offs, which is excluded in a pro forma adjustment in the testimony of Mr. McFadden, and is included in Schedule MPM-53 R-2.

Q. Did you prepare a schedule showing the balance of ADIT associated with utility plant?

A. Yes. It can be found at Schedule CP–3 R-2. In the schedule, I have broken utility-plant-related ADIT down into the following categories:

- ***Accelerated depreciation and other*** – includes the federal deferred taxes that either arise or reverse through depreciation deductions (including bonus depreciation) allowed pursuant to sections 167 and 168 of the Internal Revenue Code ("IRC").
- ***Safe Harbor Adjusted Repair Expense ("SHARE") deductions*** – includes federal deferred taxes associated with projects that are claimed as deductible repair expenses pursuant to IRC section 162 but are capital assets for financial reporting purposes. This deduction is described in more detail below.
- ***Mixed Service tax deduction*** – includes existing federal deferred taxes associated with projects that historically claimed a tax deduction for Mixed Service costs under IRC 162. This deduction is described in more detail below.
- ***NJ corporate business tax*** – includes all deferred taxes provided for the NJ Corporate Business Tax.

Mr. McFadden has reflected these deferred taxes as a rate base reduction in Schedule MPM–03 R-2.

<u>SHARE Deduction</u>

Q. What is a SHARE deduction?

A. The SHARE deduction is an acronym for the repair deductions discussed below.

Q. What are repair deductions?

A. On September 12, 2011, the IRS released Revenue Procedure 2011-43, which was later modified in Revenue Procedure 2014-16, detailing a safe harbor method for determining repair deductions for electric transmission and distribution property. Generally, for book and tax purposes, costs are either capitalized into the depreciable basis of an asset or currently expensed for book purposes and deducted for tax purposes. For tax purposes, costs associated with a unit of property are considered deductible repair expenses and not capitalized unless they are incurred for either a) betterment of the property, b) restoration of the property, or c) to adapt the unit of property to a new or different use as determined under the Revenue Procedure.

Q. How do the repair deduction rules apply?

A. These rules apply to all vintages of property and permit immediate expensing of all costs associated with projects considered a deductible repair expense pursuant to IRC section 162, resulting in a tax reduction in the year incurred, but are capital assets for financial reporting and ratemaking purposes. PSE&G has claimed enhanced repair deductions since 2010 for both its electric and gas distribution operations (referred to as a "SHARE deduction"). SHARE deductions are considered unprotected.

Q. Has the IRS provided additional guidance on the Gas SHARE deductions?

A. Yes. In April 2023, the Treasury released Revenue Procedure 2023-15 associated with determining the repair deduction for gas transmission and distribution property.

The impact, if any, of this Revenue Procedure is in process of being determined and possibly may require additional authoritative guidance. The Company reserves the right to propose an adjustment to the TAC to capture the impact of Revenue Procedure 2023-15 including any further guidance issued.

Q. How is the SHARE deduction returned to customers?

A. The SHARE deduction is returned to customers through the TAC in two ways: 1) amortization of the historic SHARE balance and 2) flow-back of the current net SHARE tax benefit. The historic SHARE was a component of the Company's ADIT in the 2018 base rate case. Per the Stipulation of Settlement approved by the Board in the 2018 Rate Case Order, the balance is being flowed-back to customers over a 10-year period, with one-third of the balance returned in the first five years and the two-thirds remaining balance returned in the remaining five years.[2] The current SHARE is calculated as the on-going, annual SHARE tax deduction less the book depreciation associated with SHARE deductions multiplied by the federal tax rate. It is contemporaneously flowed back to PSE&G's customers.

Q. Is the SHARE deduction the same each year?

A. No. The SHARE deduction has the potential to significantly vary year-to-year based on the actual plant activity and mix of capital projects placed in service each year that qualifies as repair, which causes volatility in the SHARE deduction.

<u>Mixed Service Deduction</u>

Q. What is a Mixed Service deduction?

A. IRC section 263A governs which costs are capitalizable, deductible, or both, referred to in Treasury Regulation Section 1.263A-1(e)(4)(ii)(C) as "Mixed Service costs." That Treasury regulation defines Mixed Service costs as service costs that are partially allocable to production or resale activities (capitalizable) and partially allocable to nonproduction or non-

[2] 2018 Rate Case Order at 9.

resale activities (deductible). Mixed Service costs are typically thought of as general and administrative costs.

Q. Can you provide an example of a Mixed Service deduction?

A. A company's personnel department may incur costs to recruit employees engaged in the production of self-constructed assets (capitalizable) as well as costs to recruit employees engaged in nonproduction activities (deductible).

Q. How does the Mixed Service deduction impact ADIT?

A. Treasury Regulation section 1.263A applies to all vintages of property and permits immediate deduction of all costs associated with projects pursuant to IRC section 162, resulting in a tax deduction in the year incurred, but are capital assets for financial reporting and ratemaking purposes. ADIT results from the timing difference between financial reporting, which is depreciated over the life of the asset, and tax reporting, which is immediately deducted. Mixed Service deductions are unprotected and not subject to the tax normalization rules.

Q. Is there more than one directive on how to calculate the Mixed Service deduction?

A. Yes. The IRS has issued a number of Industry Director Directives ("IDDs") related to the computation of the Mixed Service deduction. Generally, the regulated utility industry follows IDD No. 5 (LMSB 04-0809-033, 2009), which is based on the simplified service cost method.

Q. Are you proposing a change in the regulatory treatment of the Mixed Service deduction in this proceeding?

A. Yes. As described below, the Company proposes to return both the historic and current Mixed Service deduction to customers through the TAC in the same manner as done for the SHARE.

Q. Do you have any workpapers or schedules supporting your current Mixed Service forecast?

A. Yes. See Schedule CP-4 R-1 for the calculation.

Deferred vs Flow-thru Accounting

Q. What is deferred tax accounting and how does it differ from flow-thru accounting?

A. Generally Accepted Accounting Principles ("GAAP"), codified as ASC 740, require comprehensive inter-period tax allocation for all temporary differences between book and tax accounting. Simply stated, a temporary difference is an item of income or expense, for which the difference in basis or timing of recognition in income differs between tax purposes and financial reporting purposes. When a temporary difference is reflected in the computation of taxable income in a different period than it is for financial reporting purposes, there is an impact on the timing of taxation, and GAAP requires that a deferred tax expense or benefit be recorded on the income statement to reflect the future reversal of that temporary difference. A deferred tax expense results in an increase in ADIT liabilities on the balance sheet, and the liability reverses as the Company repays the temporary benefit to the government in the form of higher tax payments in the future. This is what I refer to as deferred tax accounting.

Q. Can you describe flow-through accounting?

A. To state it simply, flow-through accounting puts the utility on a tax return basis (cash basis) for tax recovery in the ratemaking process. Tax expense or benefit of the particular item will flow to customers in the year in which the taxes are reflected in the tax return. Deferred tax accounting, in contrast, matches the tax impact of an item of expense or income with the recovery of that item from customers.

Q. Is either the flow-through or deferred tax accounting method required?

A. Neither method is required in setting rates, subject to two exceptions.

First, for ratemaking purposes, when the tax normalization rules apply, deferred tax accounting is required. Normalization rules apply to deductions associated with accelerated depreciation claimed pursuant to IRC sections 167 and 168. The deduction for accelerated depreciation will be forfeited if the normalization rules are violated by flowing back tax depreciation benefits to customers too quickly. The normalization rules do not apply to deductions claimed under any other section of the Code, such as the SHARE and Mixed Service deductions that are claimed under IRC section 162.

The second exception is that N.J.S.A. 48:2-21.34 requires deferred tax accounting in setting utility rates for all temporary differences used in computing New Jersey ("NJ") State income tax. Therefore, no ADIT computed at the NJ rate may be flowed through, and instead, normalization would be required for the NJ State income tax portion of the SHARE and Mixed Service deductions.

IV. TAX ADJUSTMENT CREDIT

Q. Can you please describe the TAC?

A. The prior base rate proceeding established a separate Electric and Gas TAC ("ETAC" and "GTAC") as set forth on Attachment C of the Stipulation of Settlement approved in the 2018 Rate Case Order. The 2018 Rate Case Order approved the following eight components of the TAC:

- A one-time refund of the excess income tax recovery from January - March 2018 was issued during the two-month period November and December 2018 and included interest based upon the Company's interest rate obtained on its commercial paper and/or bank credit lines utilized in the preceding month;[3]
- Refund of the protected excess deferred tax balance, which is flowed back to customers under the ARAM or any other method as required by the IRS;
- Refund of the unprotected excess deferred tax balance over an approximately five (5) year period through December 31, 2023, with the annual amortization as shown in Attachment C of the Stipulation;
- Refund of the historic SHARE balance as of October 31, 2018 over a 10 year period, with one-third of the balance returned over the first approximately 5 years through December 31, 2023, and the balance returned over the remaining 5 year period ending December 31, 2028;
- Return on the increase in rate base at the Company's after-tax WACC from the flow-through of rate base related excess deferred taxes (comprised of all protected excess

[3] These amounts have been flowed back to customers and has no impact on the current rate proceeding.

deferred taxes, the historic SHARE, and a portion of the unprotected excess deferred taxes as shown in Attachment C of the Stipulation);

- Payment of interest at the Company's after-tax WACC on the balance of the non-rate base related excess deferred taxes until fully refunded over the approximately 5-year period;
- Flow-through of the estimated current period SHARE deduction, plus or minus true-ups from prior periods, calculated as the actual SHARE tax deduction less all associated SHARE book depreciation, multiplied by the Federal tax rate. Any true ups from prior periods will be flowed back to customers in the next appropriate period. Note, this adjustment is inclusive of expenses that made up the ADR repair allowance deduction previously in base rates such that all repair related flow through will be done through the TAC; and
- A revenue gross-up of the net tax flow-through.

The mechanics of the TAC are discussed in the Direct Testimony of Mr. Steven Swetz. Additionally, Attachment C of the Stipulation of Settlement adopted by the Board in the 2018 Rate Case Order set forth the EDIT and SHARE tax benefit balances to be flowed back to customers monthly for the period Jan 2018 through December 2019 and the annual flow back of the protected and unprotected excess deferred taxes for years 2020 through 2029.

Q. Have the balances of the Protected and Unprotected Excess ADIT changed since the 2018 Rate Case Order?

A. Yes. The balances for the Protected and Unprotected Excess ADIT, which were approved to be refunded in the 2018 Rate Case Order, changed for four reasons:

1) A reclassification between the protected and unprotected balance;

2) An ADIT adjustment as a result of the 2017 federal and state return to accruals ("RTA");

3) The result of the IRS ruling on the Company's PLR requests with regard to a change in accounting method and the treatment of cost of removal expenditures, which is discussed in more detail below; and

4) An IRS audit settlement of tax years prior to 2018.

The first two adjustments were included in the Company's 2019 TAC filing and subsequently adjusted to reflect the immaterial impact of the federal benefit of state taxes that resulted from the 2017 state return to accrual.[4] The IRS guidance on the Company's PLR request was not available at the time of the Company's 2019 TAC filing as it was issued in April 2020. The Company incorporated the results of the PLR requests into the final approved TAC rates approved by the Board on July 16, 2020. There has been no change to the Company's historic SHARE balance. The Company has settled its 2011 through 2016 tax return audit with the IRS and reflected any changes to the excess deferred taxes as a result of the settlement in the fourth quarter of 2020. These impacts were included in the 2021 TAC filing.[5]

Q. Do the first two adjustments (reclassification and 2017 RTA) approved in the 2019 TAC filing affect the current filing?

A. Yes. While the adjustments to the balances occurred in 2018, the relative amortization related to these adjustments are being amortized through 2023.

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[4] *I/M/O the Petition of Public Service Electric and Gas Company for Approval of Changes in Its Electric Tax Adjustment Credit and Gas Tax Adjustment Credit ("2019 TAC Filing")*, BPU Docket Nos. ER19091302 and GR19091303 (filed September 26, 2019).

[5] *I/M/O the Petition of Public Service Electric and Gas Company for Approval of Changes in its Electric Tax Adjustment Credit and Gas Tax Adjustment Credit ("2021 TAC Filing")*, BPU Docket Nos. ER21101201 & GR21101202 (filed October 29, 2021) at Attachment 1 at 10.

Q. Please explain what are the PLR reclassifications between protected and unprotected deferred income taxes?

A. In compliance with the Company's Base Rate Case Order, PSE&G sought a PLR from the IRS that would give guidance as to whether excess deferred income tax associated with accounting changes to repair deductions and mixed service costs are protected in nature and subject to normalization rules. In addition, PSE&G also required a PLR from the IRS regarding its post-1981 cost or removal and whether amounts were subject to normalization rules and if it is to be treated as a separate temporary difference or part of the overall depreciation temporary difference.

Q. Did PSE&G obtain those private letter rulings?

A. Yes. In April 2020, the IRS issued a ruling to PSE&G that held both the deficient deferred taxes related to COR and the excess deferred taxes associated with accounting method changes related to repair deductions and the capitalization of mixed service costs are unprotected and not subject to the tax normalization rules.

Q. What excess amounts will be amortized pursuant to those PLRs?

A. Pursuant to the guidance in the PLR, PSE&G is flowing back $75 million in total net pre-tax credits to customers. Of that amount, approximately $41 million and $34 million in excess deferred income taxes will be amortized to electric and gas customers, respectfully, through 2024.

Q. Are these amounts currently being amortized back to customers?

A. Yes. On July 16, 2020, the Board approved PSE&G's Updated 2019 TAC filing including the reclassification pursuant to the IRS guidance that these deficient deferred taxes related to COR and the excess deferred taxes are not subject to the tax normalization rules. As such, these amounts have been reclassified and are being amortized through the TAC effective July 16, 2020, as approved by the Board.

Q. What are the benefits associated with the TAC?

A. There are several benefits associated with the TAC:

- Utilizing the TAC allows for an uneven method of amortization, which the Company could not do in a traditional base rate amortization without an annual base rate case.
- It provides a mechanism to stop the amortization of historical ADIT once the repair-related ADIT is fully returned to customers, to avoid possible IRS normalization violations.
    - If the Company were to over-amortize the SHARE-deduction-related ADIT balance, the excess amortization arguably would come from the depreciation-related ADIT, which is protected by the normalization rules. Reversing that deferred tax would result in a normalization violation and the possibility of significant penalties. Use of the TAC eliminates that risk.
- The TAC provides a mechanism that will permit the recovery of IRS audit adjustments, changes, or subsequent clarifications to tax law, or other major tax changes, if any.
    - For example, while the IRS has not challenged the Company's SHARE deductions, tax deductions of this magnitude are routinely scrutinized. Given the size of these deductions and the IRS's policy of auditing multiple years at a time, a final disallowance could be material. Because the tax benefit of any deductions will have already been passed to customers, any IRS disallowance and interest thereon would need to be recovered from customers. The TAC will provide the mechanism to ensure timely recovery.

Q. What is the status of the Excess Deferred Tax balance to be flowed back through the TAC?

A. The reduction in the federal tax rate generated a total of $1 billion of excess deferred taxes. Through the end of 2023, the balance remaining of protected EDIT to be flowed back to customers is approximately $862 million. The majority of unprotected EDIT was flowed back as of December 31, 2023, and the remaining unprotected EDIT of approximately $20 million is related to the PLR and will be flowed back during 2024. For the test period, the flow back to customers is included in this filing.

Q. Are there any adjustments to the TAC as originally approved in the 2018 rate case?

A. Yes. PSE&G proposes the following adjustments, which are described in more detail later in my testimony:

1) In addition to continuing to flow back the benefit of the historic SHARE deduction, the Company proposes to flow back to customers the net federal tax benefit associated with the historical Mixed Service ADIT balance over approximately five years.

2) The Company proposes to add the current Mixed Service deduction net benefit to the current SHARE deduction net benefit already included in the TAC, but both at a pre-determined, fixed annual amount, with any excess to be flowed back to customers in a subsequent rate case;

3) To better match the seasonal flow of Company pre-tax income, the Company began to amortize the monthly flow back of EDIT and SHARE on a seasonal basis in the 2023 TAC filing to match pre-tax income as described in the 2023 TAC cost recovery

proceeding.[6] In this proceeding, the Company is aligning the return calculation with the seasonal amortization methodology; and

4) The Company proposes to recover/refund the annual impact of the CAMT liability as a result of the IRA through the TAC.

I discuss each proposed change below.

1) Historic Mixed Service

Q. Why are you proposing to flow back the historic Mixed Service deduction through the TAC?

A. The historic Mixed Service deduction is an unprotected deferred tax liability that can be flowed back to customers. This is similar to the current mechanism to flow back the historic SHARE to customers with the exception that it would be over an approximate three-year period instead of 10 years as approved in the last rate case for the historic SHARE. The historic Mixed Service balance is part of ADIT and reducing the Company's rate base. As the tax benefit is flowed back to customers, the ADIT balance declines and the Company's rate base increases. In the same manner as approved for the historic SHARE, the Company can refund this tax benefit to customers on an accelerated basis and earn a return on the increased rate base as a result of the refunds. The TAC allows for the accelerated refund of the Mixed Service net tax benefit while earning its allowed return as its rate base increases. The projected Mixed Service historic ADIT balance as of August 31, 2024 is approximately $366 million, and grossed up to revenues would represent a benefit to customers of $509 million. See Schedule CP-4 R-1 for

[6] *I/M/O the Petition of Public Service Electric and Gas Company for Approval of Changes in Its Electric Tax Adjustment Credit and Gas Tax Adjustment Credit ("2023 TAC Filing")*, BPU Docket Nos. ER23090634 and GR23090635 (filed September 1, 2023) (the "2023 TAC Filing").

the historic Mixed Service deduction that the Company proposes to be flowed through to customers through the TAC.

2) Annual SHARE and Mixed Service Deduction

Q. Are you proposing to flow back the annual Mixed Service deduction to customers as well?

A. Yes. As described below, the Company proposes that a fixed annual flow back amount be refunded to customers for both the annual SHARE and Mixed Service deductions.

Q. What is the annual Mixed Service and SHARE flow back?

A. The annual SHARE flow back is the annual Federal repair tax deduction less the associated book depreciation multiplied by the federal tax rate. Likewise, the annual Mixed Service flow back is the annual federal Mixed Service tax deduction less the associated book depreciation multiplied by the federal tax rate.

Q. Can you please discuss the proposal to limit the flow-back of the annual net SHARE and Mixed Service deductions?

A. To ensure that PSE&G customers receive the full benefit of these deductions while minimizing fluctuations in Distribution Customers' bills, the Company proposes to flow back a fixed annual benefit of $40 million and $16 million related to the annual SHARE and Mixed Service deduction, respectively, or a combined impact of $56 million. The actual SHARE and Mixed Service deductions will continue to be calculated and tracked annually. To the extent the actual benefit is higher than the proposed flow back amount, the excess would be added to the ADIT balance and flowed back to customers in a subsequent rate case.

Q. What is the benefit of this approach to limit the flow back amounts?

A. A fixed flow back amount will reduce the rate volatility and revenue requirement swings currently occurring in the existing TAC. The Current SHARE fluctuates annually and has seen significant swings, typically recorded in December. In addition, deferring the difference between the actual and proposed flow back amount can increase ADIT and provide an additional unprotected balance to be refunded to customers in a future rate case.

Q. Can you provide a simple example of how the deferral will work?

A. Yes. Assume this proposal is accepted and allows for a net SHARE deduction of $100 be flowed back to customers. However, the actual benefit is $150. The $50 additional benefit would be added to the existing ADIT balance, reduce rate-base, and be flowed back to customers in a subsequent rate case.

3) Monthly Amortization Pattern

Q. Can you please describe why the monthly amortization pattern of EDIT and SHARE flowback has changed and the impact to the return calculation?

A. As described in the Company's 2023 TAC Filing, the Company has changed the monthly amortization pattern to reflect the seasonality of pre-tax income. Historically, approximately 33% of the Company's revenue is generated in the first quarter each year. However, the tax benefits from flowing back the EDIT and SHARE were amortized on a straight-line basis, which caused a monthly mismatch. As a result, in 2023 the Company changed the monthly amortization of the EDIT and SHARE flowback to follow the seasonal pattern as the Company generates pre-tax income. The full-year total to be flowed to customers is not impacted. For the impact to the return calculation, see Schedule SS-ETAC-

1E R-2 for electric and Schedule SS-GTAC-1G R-2 for gas in the Direct Testimony of Mr. Swetz.

4) CAMT

Q. Why do you propose to recover the CAMT through the TAC?

A. There still remains uncertainty on the calculation/rules of the CAMT and its impact to PSE&G as the industry awaits additional guidance from the US Treasury. The TAC allows the Company to adjust annually for any impact resulting from additional US Treasury guidance and interpretation of existing guidance. Further, the TAC provides for a return on the increase in rate base as deferred taxes decline. The CAMT will work in the same way where the Company would calculate a return on the change in rate base as a result of the change in deferred taxes in the annual TAC filings.

Revised TAC

Q. Has the TAC been modified to reflect all of the changes you describe above?

A. Yes. Please see Schedule SS-ETAC-1E R-2 and Schedule SS-GTAC-1G R-2 of Mr. Swetz's testimony for the updated TAC reflecting:

1) The continued refund of the protected EDIT under ARAM;
2) The continued refund of the Historic SHARE (increased to reflect 2/3 of the October 31, 2018, balance as approved in the 2018 base rate case;
3) The new flow back of the Historic Mixed Service Deduction proposed to be added in this proceeding;
4) The adjustment to deferred taxes and rate base as a result of the CAMT;
5) The return on the flow backs as they are returned to customers and the change in deferred taxes as a result of the CAMT; and

6) The fixed flowback of the combined Current SHARE and Current Mixed Service deductions to account for the forecasted future deductions.

V. CONSOLIDATED TAX ADJUSTMENT

Q. What is a Consolidated Tax Adjustment?

A. To state it simply, a Consolidated Tax Adjustment ("CTA") is a ratemaking adjustment designed to pass some or all the benefit of tax savings generated by nonregulated subsidiaries of a consolidated return filing group to the regulated affiliate.

Q. What is the Board's policy regarding CTAs?

A. On January 23, 2014, the Board issued an order opening Docket EO12121072, a generic proceeding to review the applicability and computation of the CTA. On November 22, 2014, the Board issued an order ("November 22 Order") in that docket setting out key computational requirements with respect to the CTA. On December 17, 2014, the Board reaffirmed the January 2014 Order. The Board found that it is appropriate to include a Consolidated Tax Adjustment in utility base rate filings and found that the current CTA policy shall remain in effect with the following modifications:

1) The review period for the calculation shall be for five calendar years including any complete year that is included in the test year;
2) The calculated tax adjustment based on that review period shall be allocated so that the revenue requirement of the company is reduced by 100% of the adjustment; and
3) Transmission assets of the EDCs would not be included in the calculation of the CTA.

Q. Have you included a computation of the CTA that is consistent with Board Order?

A. Yes I have. In Confidential Schedule CP–5 R-1, I have provided the detailed computation using the approved Board Order. The resulting CTA reduces rate base by approximately $4 million for electric and $0 for gas.[7] These reductions have been considered in this rate proceeding. Mr. McFadden has included this amount in rate base as shown in Schedule MPM–3 R-2.

Q. Does this conclude your testimony at this time?

A. Yes, it does.

[7] Please note that the change to the electric rate base reduction from "approximately $3 million" (in Mr. Pardo's 9+3 Update testimony (Exhibit P-4 R-1)) to "approximately $4 million" in this sentence reflects only an update to match the testimony to the data in Schedule CP-5 R-1, which was provided in the Company's 9+3 Update. The underlying calculations in Schedule CP-5 R-1 have not changed.

Distribution Rate Case 12x0
Test Period - June 2023 - May 2024 Actuals

	Electric Distribution	Gas Distribution	Total
a - Current Federal Tax Exp	22,294,560.67	10,762,628.57	33,057,189.24
b - Current State Tax Exp	22,648,893.69	839,552.78	23,488,446.47
c - Deferred Federal Tax Exp	(33,539,745.20)	(69,861,940.00)	(103,401,685.20)
d - Deferred State Tax Exp	9,921,577.16	23,821,469.69	33,743,046.85
e - ITC Expense	(5,618,921.36)	(991,284.29)	(6,610,205.65)
Total Tax Expense	15,706,364.96	(35,429,573.26)	(19,723,208.30)
Total Current Tax Expense	44,943,454.36	11,602,181.35	56,545,635.71
Total Deferred tax Expense	(29,237,089.40)	(47,031,754.61)	(76,268,844.01)
Total Tax Expense	15,706,364.96	(35,429,573.26)	(19,723,208.30)

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
Schedule CP-3
Accumulated Deferred Income Taxes
RR12N0 - 0013

ACCUMULATED DEFERRED TAXES - ELECTRIC
($000)

	Actuals 12/31/2022 Balance	Actuals 12/31/2023 Balance	Actuals 5/31/24 Balance	Estimated 11/30/24 Balance	Estimated 12/31/24 Balance
Depreciation & Other	$ (1,069,347)	$ (1,036,682)	$ (1,046,278)	$ (1,056,899)	$ (1,058,227)
Repair Deduction	$ (73,434)	$ (63,879)	$ (58,054)	$ (48,585)	$ (46,868)
Mixed Service Deduction	$ (163,425)	$ (171,400)	$ (176,969)	$ (184,256)	$ (185,471)
NJ Corporate Business Tax	$ (386,253)	$ (428,706)	$ (446,602)	$ (477,857)	$ (482,764)
Total Electric Accumulated Deferred Taxes	$ (1,692,459)	$ (1,700,666)	$ (1,727,903)	$ (1,767,597)	$ (1,773,330)
Proforma Adjustments:					
Adjusted Electric Accumulated Deferred Taxes	$ (1,692,459)	$ (1,700,666)	$ (1,727,903)	$ (1,767,597)	$ (1,773,330)

ACCUMULATED DEFERRED TAXES - GAS
($000)

	Actuals 12/31/2022 Balance	Actuals 12/31/2023 Balance	Actuals 5/31/24 Balance	Estimated 11/30/24 Balance	Estimated 12/31/24 Balance
Depreciation & Other	$ (898,319)	$ (864,423)	$ (873,050)	$ (876,563)	$ (877,138)
Repair Deduction	$ (203,465)	$ (179,963)	$ (165,784)	$ (157,435)	$ (155,768)
Mixed Service Deduction	$ (147,688)	$ (155,979)	(161,378)	$ (168,954)	$ (170,217)
NJ Corporate Business Tax	$ (441,059)	$ (489,050)	$ (498,736)	$ (520,631)	$ (524,338)
Total Gas Accumulated Deferred Taxes	$ (1,690,531)	$ (1,689,415)	$ (1,698,948)	$ (1,723,585)	$ (1,727,461)
Proforma Adjustments:					
Adjusted Gas Accumulated Deferred Taxes	$ (1,690,531)	$ (1,689,415)	$ (1,698,948)	$ (1,723,585)	$ (1,727,461)

PSE&G 2023 Base Rate Case
Schedule CP-4 R-1
Proposed Historic Mixed Service Flowback
12x0

ADIT Balance for Mixed Service	Actual ADIT 2023	Projected 2024 Activity Jan - Aug	Projected Total ADIT as of 8/31/2024
Electric Distribution	185,423,875	5,275,889	190,699,763
Gas Distribution	169,162,896	6,045,172	175,208,068
Total Distribution	354,586,771	11,321,061	365,907,831
Grossed up to Revenues	493,235,180	15,747,754	508,982,934

PSE&G 2023 Base Rate Case
Schedule CP-4 R-1
Proposed Fixed Annual Mixed Service Flowback
12x0

Summary Current Mixed Service Projection (2025-2029)

	Projected Current Mixed Service				
	2025	2026	2027	2028	2029
ED Tax Deduction	13,434,213	14,757,392	15,667,891	18,303,176	19,086,241
ED Book Depreciation Addback	(5,418,122)	(5,418,122)	(5,418,122)	(5,418,122)	(5,418,122)
Net ED Mixed Service Deduction	8,016,091	9,339,271	10,249,770	12,885,055	13,668,120
Proposed ED Fixed Annual Mixed Service Flowback	**9,000,000**	**9,000,000**	**9,000,000**	**9,000,000**	**9,000,000**
GD Tax Deduction	12,330,682	11,766,650	10,820,864	11,519,955	11,834,346
GD Book Depreciation Addback	(3,711,207)	(3,711,207)	(3,711,207)	(3,711,207)	(3,711,207)
Net GD Mixed Service Deduction	8,619,475	8,055,443	7,109,657	7,808,749	8,123,139
Proposed GD Fixed Annual Mixed Service Flowback	**7,000,000**	**7,000,000**	**7,000,000**	**7,000,000**	**7,000,000**
Total Proposed Distribution Annual Mixed Service Flowback	16,000,000	16,000,000	16,000,000	16,000,000	16,000,000

		2024	2025	2026	2027	2028	2029
ED	Ending CWIP (FERC excludes Common)	397,460,496	386,994,155	697,471,000	822,708,954	1,054,754,369	957,413,182
	Beg CWIP	(470,621,562)	(397,460,496)	(386,994,155)	(697,471,000)	(822,708,954)	(1,054,754,369)
	Increase/(Decrease)	(73,161,066)	(10,466,341)	310,476,845	125,237,954	232,045,415	(97,341,187)
	Fixed Asset Additions (FERC exclude Land)	1,092,836,418	1,035,365,251	815,367,704	1,070,068,733	1,164,307,729	1,553,434,534
	Total Additions NET of chenge in CWIP	**1,019,675,352**	**1,024,898,910**	**1,125,844,550**	**1,195,306,687**	**1,396,353,144**	**1,456,093,347**
	Book Ratio	93.44%	93.44%	93.44%	93.44%	93.44%	93.44%
		952,790,371	957,671,294	1,051,995,466	1,116,901,277	1,304,760,214	1,360,581,796
	over capitalization as a % of contruction exp	6.68%	6.68%	6.68%	6.68%	6.68%	6.68%
	Est IDD Deduction	**63,646,397**	**63,972,442**	**70,273,297**	**74,609,005**	**87,157,982**	**90,886,864**

IDD taken Per Return

		2024	2025	2026	2027	2028	2029
GD	Ending CWIP (FERC excludes Common)	66,156,646	76,988,732	46,097,042	62,852,770	148,566,342	167,547,243
	Beg CWIP	(93,510,722)	(66,156,646)	(76,988,732)	(46,097,042)	(62,852,770)	(148,566,342)
	Increase/(Decrease)	(27,354,076)	10,832,086	(30,891,690)	16,755,727	85,713,573	18,980,900
	Fixed Asset Additions (FERC exclude Land)	1,015,875,885	929,878,205	928,571,854	808,770,250	793,146,224	883,863,825
	Total Additions NET of chenge in CWIP	**988,521,809**	**940,710,291**	**897,680,164**	**825,525,978**	**878,859,797**	**902,844,726**
	Book Ratio	93.44%	93.44%	93.44%	93.44%	93.44%	93.44%
		923,680,326	879,004,976	838,797,384	771,376,107	821,211,527	843,623,179
	over capitalization as a % of contruction exp	6.68%	6.68%	6.68%	6.68%	6.68%	6.68%
	Est IDD Deduction	61,701,846	58,717,532	56,031,665	51,527,924	54,856,930	56,354,028

FERC Additions						
Electric	1,092,836,418	1,035,365,251	815,367,704	1,070,068,733	1,164,307,729	1,553,434,534
Adjusted Electric Additions	1,092,836,418	1,035,365,251	815,367,704	1,070,068,733	1,164,307,729	1,553,434,534
Gas	1,015,875,885	929,878,205	928,571,854	808,770,250	793,146,224	883,863,825
Adjusted Gas Additions	1,015,875,885	929,878,205	928,571,854	808,770,250	793,146,224	883,863,825