

Prefiled Direct Testimony  
Aaron J. Bjorkman

Before the South Dakota Public Utilities Commission  
of the State of South Dakota

In the Matter of the Application of  
NorthWestern Corporation, d/b/a NorthWestern Energy

For Authority to Increase Electric Utility Rates  
in South Dakota

Docket No. EL23-\_\_\_\_\_

June 15, 2023

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**Witness Information**

**Q. Please provide your name, employer, and title.**

**A.** My name is Aaron J. Bjorkman, and I am NorthWestern Energy’s (“NorthWestern” or “Company”) Director - Corporate Taxes. I am responsible for all tax related compliance, research, and planning activities for NorthWestern.

**Q. Please provide a description of your relevant employment experience and other professional qualifications.**

**A.** I have over 20 years of experience in the field of corporate taxation, 15 years of which I spent working in the public utility sector with NorthWestern. Prior to my employment at NorthWestern, I worked as a Certified Public Accountant for Deloitte and for RSM, spending the majority of my time on corporate taxation. I have a Bachelor of Science degree in Accounting and a Master’s in Professional Accountancy from the University of South Dakota.

**Q. Have you previously testified before the South Dakota Public Utilities Commission (“Commission” or “SD PUC”)?**

**A.** No, however I have testified in multiple dockets in other jurisdictions.

**Purpose of Testimony**

**Q. What is the purpose of your testimony in this proceeding?**

**A.** I provide testimony in support of income tax-related items included in this filing. All income tax items in both the income statements and rate base exhibits were

1 prepared under my supervision and control. I am sponsoring Statement K -  
2 Income Taxes.

3  
4 **Income Taxes**

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

8 **A.** Yes. The income taxes included in this filing have been calculated utilizing the  
9 partial flow-through method that the Commission has approved in prior dockets.  
10 Partial flow-through was utilized as part of recent dockets, including EL14-106  
11 and GE17-003. Plant-related tax adjustments, except for those subject to  
12 mandatory normalization under Section 168 of the Internal Revenue Code  
13 (“IRC”), are generally flowed through to customers as a reduction to the income  
14 tax expense included in the revenue requirement.

15  
16 **Q. Have the impacts of the Tax Cuts and Jobs Act (“TCJA”) been reflected in**  
17 **this filing?**

18 **A.** Yes. The TCJA methodologies related to Excess/Deficient Deferred Income  
19 Taxes (“EDIT”) as established in Docket No. GE17-003 are continued as part of  
20 this rate review.

21  
22 **Rate Base Deferred Taxes**

23 **Q. What are deferred income taxes?**

1 **A.** Deferred taxes are differences between the book and tax treatment for certain  
2 transactions. Accelerated tax depreciation generally exceeds book depreciation  
3 during the early years of an asset's service life, creating an accumulated deferred  
4 income tax liability.

5  
6 **Q. Why are certain deferred income taxes a reduction to rate base?**

7 **A.** Since deferred income taxes are typically liabilities for taxes due in future  
8 periods, they represent a source of funds. Accordingly, the average accumulated  
9 deferred income tax liability balance is deducted from rate base to recognize  
10 such funds are available for NorthWestern to use between the time they are  
11 collected in rates from customers and the time they are eventually remitted to the  
12 government.

13  
14 **Q. Please explain how deferred taxes related to Production Tax Credits  
15 ("PTCs") are being reflected in rate base.**

16 **A.** Deferred tax assets ("DTA") are related to PTCs, which have been provided to  
17 customers through NorthWestern's Delivered Cost of Fuel Adjustment  
18 Computation ("Fuel Tracker") as they are earned. This occurs even though the  
19 PTCs have not yet been utilized and monetized by NorthWestern, primarily due  
20 to its historical net operating loss ("NOL") created as a result of many years of  
21 accelerated bonus tax depreciation enacted by legislation. Although  
22 NorthWestern no longer has any remaining NOLs, PTC DTAs have not yet been  
23 fully utilized. Because the DTAs related to PTCs have been provided to

1 customers, but the PTCs have not yet been monetized by NorthWestern, these  
2 PTC DTAs should be included in rate base. Including the PTC DTAs in rate base  
3 corrects an inequity that has distorted historical recovery relative to the  
4 Company's balance sheet.

5  
6 Including PTCs in rate base is analogous to the Company adjusting rate base for  
7 plant-related normalized depreciation deferred tax liabilities ("DTL"). In the case  
8 of the plant-related DTL, the Company reduces rate base as a "credit" because  
9 otherwise it is effectively receiving an interest-free loan for the accelerated tax  
10 depreciation that occurs. PTCs and the resulting PTC DTAs only exist because  
11 of the presence of the underlying generation facility assets that create plant-  
12 related DTLs that reduce rate base. The PTC DTA could be viewed as a  
13 reduction to the plant-related DTL, or "credit."

#### 14 15 **Cost of Removal and Salvage Change**

16 **Q. Please explain the adjustments made with respect to the tax accounting**  
17 **related to removal and salvage costs.**

18 **A.** In order to explain this adjustment, I will first discuss the current accounting for  
19 these costs. NorthWestern is currently analyzing the treatment of its deferred tax  
20 accounting for the temporary book/tax differences related to the estimated cost of  
21 removing depreciable plant after its retirement and the estimated salvage value  
22 at such time in light of recent Private Letter Rulings ("PLR") issued by the Internal  
23 Revenue Service ("IRS").

1 NorthWestern accrues both future costs of removals (“COR”) as well as future  
2 salvage value (herein referred to as “net COR”) as a component of the overall  
3 book depreciation expense recorded for regulatory and financial accounting.  
4 Accrued COR (within book depreciation) results in an increase in book  
5 depreciation expense in NorthWestern’s regulatory books of account.  
6 NorthWestern does not receive a tax deduction for COR until the cost is incurred  
7 at the end of life disposition of the asset. Accrued salvage (also within book  
8 depreciation) results in a decrease of book depreciation expense in  
9 NorthWestern’s regulatory books of account. NorthWestern is subject to taxation  
10 on salvage amounts received upon end of life disposition of the asset.

11  
12 Overall, the accrual of net COR has been creating a net DTA over the life of the  
13 assets. The accrued net COR was not separately accounted for from accrued  
14 book depreciation within NorthWestern’s book depreciation software until late  
15 2013, and NorthWestern has never separated accrued salvage from accrued  
16 removal costs within the book depreciation software. The tax software has only  
17 utilized the accrued portion of net COR in 2013 and 2014 and has otherwise  
18 continued to include net COR as part of book depreciation expense in the  
19 accumulation of overall deferred taxes.

20  
21 Pursuant to the partial flow-through methodology addressed earlier in my  
22 testimony, NorthWestern has been treating the incurred net COR as a flow-  
23 through item. However, since accrued net COR has been combined with book

1 depreciation, those deferred taxes have inadvertently not received flow-through  
2 treatment, but instead have been normalized. This mismatched tax accounting  
3 continues to build a regulatory asset at the end of the asset lives as customers  
4 have been receiving benefits of incurred net COR, but have not been paying  
5 these expenses as the net COR was being accrued. That regulatory asset does  
6 not currently have an automated mechanism within the tax software to reverse  
7 over time since the regulatory asset has been created at end of life with no  
8 adjustments to the regulatory asset during the life of the property creating the  
9 book to tax differences.

10  
11 Based on recent PLRs, including PLR 202033002, PLR 202124003, PLR  
12 202141001, PLR 202150003, and ultimately leading up to PLR 202211004<sup>1</sup>,  
13 accrued and incurred CORs are not subject to normalization; however accrued  
14 and received salvage is subject to normalization. In PLR 202141001, the IRS  
15 stated that:

16 1) Taxpayer's Deferred Tax Asset ("DTA") for cumulative timing  
17 differences between (a) recognition of accrued gross COR with  
18 respect to public utility property as an increase in depreciation  
19 expense in its regulatory books of account and (b) the subsequent  
20 tax deduction of such costs upon disposition is not subject to the  
21 normalization rules of Code Section 168(i)(9) and the associated  
22 excess deferred tax amount is not subject to the normalization rules  
23 of TCJA Section 13001(d).

24  
25 2) Taxpayer's Deferred Tax Liability ("DTL") for cumulative timing  
26 differences between (a) recognition of accrued gross salvage value

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<sup>1</sup> Private Letter Rulings referenced can be found at:  
[202033002.pdf \(irs.gov\)](https://www.irs.gov/pub/irs-wd/202033002.pdf), <https://www.irs.gov/pub/irs-wd/202124003.pdf>  
[202141001.pdf \(irs.gov\)](https://www.irs.gov/pub/irs-wd/202141001.pdf), <https://www.irs.gov/pub/irs-wd/202141001.pdf>  
[202150003.pdf \(irs.gov\)](https://www.irs.gov/pub/irs-wd/202150003.pdf), <https://www.irs.gov/pub/irs-wd/202150003.pdf>  
[202211004.pdf \(irs.gov\)](https://www.irs.gov/pub/irs-wd/202211004.pdf), <https://www.irs.gov/pub/irs-wd/202211004.pdf>



1 with respect to public utility property as a reduction of depreciation  
2 expense in its regulatory books of account and (b) the subsequent  
3 taxation of such salvage amounts upon disposition is subject to the  
4 normalization rules of Code Section 168(i)(9) and the associated  
5 excess deferred tax amount is subject to the normalization rules of  
6 TCJA Section 13001(d) regardless of whether the gross salvage  
7 value timing differences are partially or fully offset by gross COR  
8 timing differences and whether the DTL related to gross salvage  
9 value differences is partially or fully offset by the DTA for gross  
10 COR differences.  
11

12 The PLR clearly provides that deferred taxes with respect to gross COR  
13 temporary differences are not subject to the normalization requirements and that  
14 deferred taxes attributable to gross salvage value temporary differences are  
15 subject to the normalization rules. Therefore, COR is allowed flow-through  
16 treatment, but salvage is “protected” and therefore is not allowed for flow-through  
17 treatment.  
18

19 In addition, PLR 202211004 specifically addresses TCJA EDIT:

20 As described, section 13001(d)(1) provides that a normalization  
21 method of accounting shall not be treated as being used if the  
22 taxpayer, in computing its cost of service for ratemaking purposes  
23 and reflecting operating results in its regulated books of account,  
24 reduces the EDIT more rapidly or to a greater extent than such  
25 reserve would be reduced under the ARAM. ARAM is defined, in  
26 part, under section 13001(d)(3)(B) as the method under which the  
27 excess in the reserve for deferred taxes is reduced over the  
28 remaining lives of the property. Commission A’s method results in  
29 the recovery of EDIT over a shorter period than the remaining life of  
30 the property. Simply stated, the annual timing difference reversal  
31 provided in Commission A’s method is overstated by the COR  
32 which is not included in the aggregate timing differences for the  
33 property at the beginning of the year. Rather than only establishing  
34 a new deferred tax asset for a new COR accrued for books, the  
35 new COR also is used to accelerate the recovery of the EDIT. This  
36 violates the Normalization Rules in section 13001 of the TCJA.  
37

1 While COR is taken into account as an element of book composite  
2 depreciation, COR does not produce a timing difference that  
3 represents the type of timing difference that is protected by the  
4 normalization rules. The COR portion in book composite  
5 depreciation represents a timing difference that will reverse when  
6 the tax benefit is realized at the time the COR is incurred. ARAM  
7 controls the return of tax expense collected from customers for  
8 which Taxpayer already has received an accelerated tax benefit,  
9 which tax benefit will not be repaid to the government as a result of  
10 the corporate rate reduction. While Taxpayer included the tax  
11 benefit of COR in cost of service, Taxpayer receives no tax benefit  
12 from the government for COR until the asset is removed from  
13 service. Any accumulated excess deferred tax asset attributable to  
14 COR represents deferred tax benefits Taxpayer has provided to  
15 customers at the 35 percent corporate tax rate, which now are  
16 expected to produce only a 21 percent current tax benefit for  
17 Taxpayer when realized as a result of the corporate tax rate  
18 reduction. While the method by which Taxpayer is permitted to  
19 recover this excess deferred tax benefit that it already has provided  
20 to customers is not governed by the Normalization Rules, those  
21 Normalization Rules do not contemplate COR timing differences  
22 accelerating the return of EDIT to customers, which is protected  
23 under the Normalization Rules.  
24

25 Based on the above PLR guidance, NorthWestern's historical ratemaking and  
26 regulatory reporting of deferred taxes for net COR and its reversal of protected  
27 EDIT is not consistent with the applicable normalization requirements.

28 Specifically, NorthWestern currently treats reversing salvage value temporary  
29 differences as flow-through items and amortizes protected EDIT more quickly  
30 than permitted under ARAM.

31  
32 For the reasons summarized above, NorthWestern must prospectively adjust its  
33 deferred tax accounting for the salvage value component of net COR incurred  
34 and the reversal of Protected Plant EDIT to become compliant with the applicable  
35 normalization requirements and avoid the sanctions for violation of such rules.

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To that end, NorthWestern has made the following adjustments as part of the 2022 normalizing plant adjustments in order to comply with IRS normalization rules:

1. NorthWestern will no longer combine accrued COR with book depreciation.

As a result, the following will be impacted:

- a. There will no longer be an excess amount of book depreciation resulting in an amount of Protected Plant EDIT reversing under ARAM in excess of the amount permitted under the normalization rules.
- b. Accrued COR (i.e., an originating book/tax difference) will prospectively receive flow-through treatment and a more appropriate matching of the tax effects of accrued COR and incurred COR will occur.

2. NorthWestern will no longer net estimated salvage within accrued COR. Accrued salvage has not historically been provided to NorthWestern as part of previous depreciation studies. However, NorthWestern has engaged a third-party consultant to compute the portion of accrued salvage within the overall accrued net COR. NorthWestern will continue to normalize the originating salvage value book/tax differences.

3. NorthWestern will no longer combine salvage value received into net COR incurred and will instead prospectively normalize salvage value received (i.e., a reversing book/tax difference).

1 4. NorthWestern proposes to recover the regulatory asset that has resulted from  
2 recording net COR under the flow-through method but recording the accrual  
3 of net COR under the normalization method evenly over 10 years beginning  
4 with the effective date of the rates.

5  
6 **Q. What are the consequences if NorthWestern does not comply with the**  
7 **deferred tax normalization requirements, including the rules related to**  
8 **TCJA excess deferred taxes, as discussed above?**

9 **A.** If NorthWestern does not comply with the deferred tax normalization  
10 requirements, it will prospectively lose the right to deduct accelerated  
11 depreciation. Instead, tax depreciation will equal regulatory depreciation  
12 expense for public utility property subject to regulation by the Commission that is  
13 in service at the time of the violation or placed in service after the violation  
14 occurs.

15  
16 **Q. Does this complete your testimony?**

17 **A.** Yes, it does.