KEITH G. BUTLER
Vice President, Tax

550 South Tryon Street
Charlotte, NC 28202

Mailing Address:
DEC41A/P.O. Box 1321
Charlotte, NC 28201-1321

o: 704 382 8681

[redacted]

April 15, 2015

The Honorable Mike Crapo
The Honorable Sharrod Brown
Co-Chairs
Savings & Investment Working Group
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, DC 20510

Re: Duke Energy Comments For Savings & Investment Working Group

Dear Senators Crapo and Brown:

On behalf of Duke Energy and the more than 7.2 million customers (roughly 22 million people) we serve in six states, I want to thank you for the opportunity to submit policy recommendations for consideration by the Senate Finance Committee. Your efforts to tackle fundamental tax reform are deeply appreciated.

The investor-owned electric power sector, of which Duke Energy is the nation's largest utility, is highly regulated, especially at the state level. Our sector is an $840 billion dollar industry that powers nearly 70 percent of America's homes and businesses. Consequently, fundamental tax reform has the ability to profoundly affect Duke Energy, our customers (which include residential, commercial, manufacturing and industrial customers) and our nation's electric power sector.

Duke Energy supports simplifying the U.S. tax code, broadening the tax base and reducing corporate tax rates. It's how we get there that presents the deepest challenge, and I hope as Congress continues to discuss and develop details it will bear in mind, and seek to mitigate, any unintended consequences that may result from implementing new, or repealing current, provisions in the Tax Code. For example, while tax provisions affect various corporations and industries differently, there are several provisions critical to Duke Energy, our customers, our shareholders, and the communities we serve that are discussed below.

Federal Income Tax Deduction for Interest Expense

One concern is that as Congress develops ways to reform the current tax code, the President's suggestion to eliminate the deductibility of interest on corporate debt will be considered for inclusion in a bill. The President suggested this policy choice in his *Framework for Business Tax Reform* as a means of providing economic neutrality between corporate debt and equity financing. However, any material change in the deductibility of interest costs would harm Duke Energy and our customers. Also, such a change would cause interest payments on debt to be subject to double taxation at the corporate and individual taxpayer levels, thereby significantly increasing the cost of debt capital and thus having a negative impact on customer rates.

Additionally, the level of reduction in the corporate tax rate being suggested by proponents of tax reform would not offset the negative financial impact a change in deductibility of interest would have on the company and our customers. In fact, eliminating the interest deduction to "pay-for" reducing the corporate tax rate below 28 percent would actually have the opposite effect and increase corporate taxes for utilities like Duke Energy—a change that ultimately would increase electric rates for our residential, commercial and industrial customers. Instead, the corporate tax rate would have to be reduced to below 25 percent in order for Duke Energy and other utilities to be financially indifferent to giving up the interest deduction provision– a level that is rarely, if ever, talked about. And this much lower corporate rate does not include eliminating other tax provisions that have been suggested by various members and outside stakeholder groups as the larger reform debate has continued to develop.

Duke Energy's Capital Structure is Already Regulated

The electric power sector is probably the most heavily regulated, as well as capital-intensive industry in the nation. Duke Energy, like most other electric utilities, has a capital structure of roughly half equity and half debt, which is typically prescribed by state regulators that oversee and approve everything from our investment decisions to our profits.

With oversight from our regulators, Duke Energy uses a carefully balanced combination of equity and long-term debt (usually a ratio of 1:1) to finance investments in assets that are expected to be in service and benefit our customer base for several decades -- assets like cleaner and more efficient power plants, modernized transmission and distribution systems, upgraded environmental controls, and other equipment critical to providing the communities we serve with affordable and reliable electric service at all times of the year, day and night. Our significant capital expenditures offer an important source of much-needed, high-quality job creation in many local towns and communities and provide a critical component for states seeking to attract increased economic development opportunities through manufacturing and industrial expansion.

The rates our customers pay for electricity reflect the Company's cost of service, including our after-tax cost of capital. We work hard on behalf of our customers to achieve the lowest cost of capital and rely upon the federal income tax deduction for interest costs to help minimize increases to electric rates—especially during this time of increased capital expansion and economic uncertainty. If Duke Energy is unable to deduct interest costs for critical infrastructure projects, the likely alternative will be to pass any additional taxes, and related higher costs, through to our customers. As an added cost for electricity, this tax increase would have all of the negative economic implications of a direct tax on energy, including a disproportionate impact on lower-income individuals and small businesses; a hindrance to the global competitiveness of energy-intensive industries, such as manufacturing; and a contributor to inflation.

Tax Policy Considerations

If Congress is seeking to balance debt and equity within a corporation's capital structure it should seek to do so in a manner that minimizes unintended consequences like those that would occur in the utility sector if the interest deduction for corporate debt was totally eliminated. Many OECD countries have addressed this issue by putting in place thin capitalization rules, which limit the amount of interest expense deduction based on the amount of debt relative to equity. Under these rules, the interest expense deduction permitted for corporate tax purposes is limited or eliminated on debt in excess of the thin capitalization requirements.

As Congress considers fundamental tax reform, it is important for policymakers to understand and appreciate the differences between regulated and non-regulated companies and the importance debt issuances play in a company's overall capital structure and cost of capital, especially for heavily regulated and capital intensive companies like Duke Energy and other electric utilities. If the goal is to rein in excess

corporate debt, Congress should look at various alternatives available, like thin capitalization rules, avoiding the one-size-fits-all approach of totally eliminating the interest expense deduction.

Normalization of Excess Deferred Taxes

A deferred tax liability – or a deferred tax – represents the amount of taxes that a company will pay in the future due to a temporary timing difference between the "book" or "regulatory" treatment of an asset on a company's financial records and the "tax" treatment based on the Tax Code.

The most common example of a deferred tax occurs when a company claims accelerated tax depreciation for an asset, such as a power plant. Using accelerated depreciation allows a company to record more "tax" depreciation in the first few years of the asset's life and less depreciation in the later years, relative to "book" or "regulatory" depreciation required by most state regulators. While this approach results in a timing difference, cumulative "tax" and "book" depreciation will generally be equal over the course of the asset's life, which in most instances is several decades.

For companies like Duke Energy that have significant deferred tax liability balances (future tax liabilities), a reduction in the federal corporate tax rate would result in excess deferred taxes (meaning less tax owed in the future). Whereas a non-regulated company would recognize excess deferred taxes as income, Duke Energy could be required to immediately refund any excess deferred taxes to our customers. Our goal, however, is to provide a fair and equitable distribution of excess deferred taxes across the current and future customer base and avoid a liquidity crisis if excess deferred taxes were required to be refunded immediately.

The major challenge facing our company is not whether refunds should take place, but rather the timing of the refund payments because, ultimately, refunds WILL be given to customers through lower rates. The question is simply who will benefit and when will they benefit.

Generally speaking, through the rate making process state regulators spread the cost of building new assets, which are significant, to the customers (both current and future) who will benefit from such investments. This is exactly what normalization achieves with special tax incentives such as bonus or accelerated depreciation. We believe the most cost-effective way to provide refunds to our customers is similar to the way they pay for the assets to begin with – spread out over time. Being required to immediately refund excess deferred taxes would disproportionately benefit current customers, who would receive the entire refund, while failing to provide future customers the same benefit.

Additionally, because most, if not all, of the deferred tax revenue has been invested in infrastructure modernization, an immediate payment could also sharply reduce Duke Energy's cash flow, resulting in one of two scenarios - either we reduce infrastructure investments or we ask for a rate increase to continue our capital expenditure plans.

Tax Policy Considerations

When Congress last reduced corporate tax rates in the Tax Reform Act of 1986, lawmakers resolved this issue by including a provision (normalization) requiring state regulators to refund excess deferred taxes over the remaining useful life of the assets that created the excess deferred taxes in the first place - essentially, spreading the benefits of the lower tax rate over the "book" depreciation schedule and viewing it, for rate making purposes as if accelerated depreciation had never occurred.

If the federal corporate income tax rate is reduced as part of tax reform legislation, Congress should include a similar provision to ensure investor-owned electric utilities have the ability to normalize (or evenly spread)

the give-back of the excess deferred taxes to their customers over time. Additionally, this protection would prevent the potential liquidity issues for Duke Energy and other utilities if normalization was not included in a bill that reduces the corporate tax rate.

International Tax Reform

The current tax code allows a domestically incorporated company to defer paying U.S. taxes on foreign generated earnings until those earnings are repatriated to the U.S. As a result of the high U.S corporate tax rate, relative to the rate of other OECD countries, the current tax structure promotes multi-national companies to reinvest foreign earnings overseas and, in some instances, leads to inefficient investment decisions.

While Duke Energy owns, operates or has substantial interests in approximately 4,900 megawatts of electric generation in Central and South America, it does not consider itself a multi-national company in the traditional sense because it produces a localized commodity that cannot be imported into or exported from the U.S. However, Duke Energy does generate foreign income and would like the opportunity to reinvest it domestically if the current US tax rules were changed to make it more economically efficient to do so.

Duke Energy's expansive domestic capital projects, such as building cleaner and more efficient power plants, strengthening our transmission and distribution systems, upgrading environmental controls, and modernizing other equipment critical to providing our customers with clean, safe and affordable electricity 24/7, are significant. The ability to have economically sound access to our foreign earnings for these investments could provide additional sources of capital and thus, enhance employment and economic development opportunities in the local towns and communities where we have operations and serve.

Tax Policy Considerations

As Congress addresses tax reform, it should seek to remove the current disincentive multi-nationals have to bring foreign source income back to the U.S. for domestic investment. Moving from a world-wide tax structure to a hybrid or pure territorial tax structure would eliminate this disincentive and allow a more efficient flow of capital from foreign to domestic jurisdictions.

Regardless of how the issue is ultimately addressed, we hope Congress will implement a more competitive and economically efficient tax rate than currently exists and remove the disincentive companies have to bringing back the more than $3 trillion in foreign earnings that is currently overseas. This revenue could provide a significant private-sector infusion of cash to the nation's still-struggling economy, helping boost infrastructure investments and creating countless direct and indirect employment opportunities throughout the manufacturing and industrial supply chain.

Dividend Tax Rates

Duke Energy commends Congress for maintaining low tax rates on dividends that are at parity with the tax rates on capital gains as part of the American Taxpayer Relief Act of 2012 (ATRA). If Congress had not acted, the top tax rate on dividends would have skyrocketed from 15 percent to 39.6 percent, while the top tax rate on capital gains would have increased from 15 percent to 20 percent. Instead, ATRA set the top tax rate for both dividends and capital gains at 20 percent for couples earning more than $450,000 ($400,000 for singles), while maintaining the lower rates for taxpayers below those income thresholds. We also commend Congress for making these rates permanent instead of doing another temporary extension.

We feel very strongly that federal tax policy should not distort investment decisions, and taxing dividends at higher rates than capital gains would create a tax policy that favors growth stocks and debt investments over dividend-paying investments. Higher dividend tax rates also would harm all Americans who invest directly in dividend-paying stocks or who invest indirectly in mutual funds.

The equity market is an important source of capital for Duke Energy, which uses the capital to invest in critical infrastructure modernization. We, and our state regulators, are very reluctant to rely more heavily on debt financing to raise capital.

Tax Policy Considerations

As Congress develops comprehensive tax reform, it should seek to continue encouraging investment by maintaining the current tax rates for both dividend yielding and growth stocks. Increasing or decoupling the tax rates could incentivize investors to pull funding from the capital markets in an attempt to seek better after-tax rates of return on their investments.

Additionally, it is important to note that dividends are currently subject to double taxation—first at the corporate level when the company pays taxes on these earnings and again, at the individual level when shareholders receive the dividends. This double taxation, which is not sound tax policy, would tend to favor debt over equity financing and create an environment that would lend to a distortion of economic decisions.

Closing

In closing, as the Senior Vice President of Tax for the nation's largest electric utility, let me reiterate Duke Energy's strong support for reforming the tax code to make it more simple, fair and efficient. I look forward to working with you and your colleagues as you continue developing appropriate policy alternatives to ensure any additional costs are minimized for the more than 22 million people we serve, as well as for the customers and communities served by other investor-owned electric utilities across our great nation.

Sincerely,
Keith G. Butler