Company: Southern California Gas Company (U 904 G)
Proceeding: 2019 General Rate Case
Application: A.17-10-008
Exhibit: SCG-37-2R

SECOND REVISED

SOCALGAS

DIRECT TESTIMONY OF RAGAN G. REEVES

(TAXES)

April 6, 2018

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

SoCalGas
A Sempra Energy utility®

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SUMMARY

- My testimony presents SoCalGas' estimated tax expense for Test Year 2019, and explains how those estimates were derived. The tax expenses discussed in my testimony include income taxes, payroll taxes, ad valorem taxes, and franchise fees.
- My testimony estimates a Test Year 2019 income tax expense of $48.2 million, payroll tax expense of $48.8 million, ad valorem tax expense of $83.4 million, and franchise fees of $39.1 million.
- The Protecting Americans from Tax Hikes Act of 2015 (the PATH Act) was enacted on December 18, 2015 (Pub. L. No. 114-113). The PATH Act extended bonus depreciation through 2019. The bonus depreciation rate is 50% through 2017 but is reduced to 40% for 2018 and to 30% for 2019.
- The Tax Cuts and Jobs Act (TCJA) was enacted on December 22, 2017 (Pub. L. No. 115-97). The TCJA made comprehensive changes to federal tax law. The changes affecting SoCalGas include: (1) a reduction of the federal corporate tax rate from 35% to 21%, effective beginning in 2018; (2) the elimination of the bonus depreciation deduction for regulated utilities; (3) the elimination of the deduction for transportation fringe benefits provided to employees beginning in 2018; and (4) a requirement to return plant-related excess deferred taxes created by the reduction in the corporate tax rate to ratepayers ratably using the Adjusted Rate Assumption Method (ARAM) as described in the TCJA.

SECOND REVISED SOCALGAS DIRECT TESTIMONY OF RAGAN G. REEVES (TAXES)

I. INTRODUCTION

A. Summary of Proposals

My testimony presents Southern California Gas Company's (SoCalGas') estimated tax expense for Test Year (TY) 2019, and explains how those estimates were derived. My testimony also presents the 2016 results of the Tax Memorandum Account (TMA).[1]

B. Organization of Testimony

SoCalGas incurs three categories of taxes: (1) payroll taxes, (2) ad valorem (*i.e.*, property) taxes, and (3) income taxes. In addition, SoCalGas incurs franchise fees, which it includes in its tax expense estimates. I will discuss each of these tax expense categories in turn.[2] A summary table for each category of tax expense is presented at the end of each section.

To the extent that the California Public Utilities Commission (CPUC or Commission) adopts levels of operations and maintenance (O&M) expense or capital that are different from what has been proposed by SoCalGas in this Application, taxes would be re-calculated to reflect the impact of those changes.

C. Impact of the Tax Cuts and Jobs Act

Purusant to the Assigned Commissioner's Scoping Memorandum and Ruling issued on January 29, 2018 (Scoping Memo), this exhibit has been revised to reflect the impact of the Tax Cuts and Jobs Act (TCJA) on the SoCalGas TY 2019 General Rate Case (GRC). The TCJA was enacted on December 22, 2017.[3] The TCJA was the most comprehensive tax reform legislation to be enacted into law in more than thirty years. The changes to federal tax law under the TCJA affected both individuals and corporations. The TCJA also included provisions specific to regulated utilities such as SoCalGas. Most of the changes to federal tax law under the TCJA became effective beginning on January 1, 2018, although certain changes related to bonus depreciation became effective on September 28, 2017. The most significant change under the TCJA for corporations generally, and for regulated utility corporations specifically, was the

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[1] The 2017 results of the TMA will not be known until the incurred amounts are final, which will occur when SoCalGas files its federal and California 2017 income tax returns. SoCalGas expects to file those tax returns in October 2018.

[2] The TMA discussion is included within the income taxes section of my testimony.

[3] Pub. L. No. 115-97, 131 Stat. 2054 (2017).

lowering of the federal corporate tax rate from 35% to 21% beginning in 2018. The lower corporate rate results in a significant decrease in SoCalGas' tax expense.

On January 5, 2018, SoCalGas filed a Prehearing Conference Statement in which SoCalGas notified the Commission that it would serve supplemental testimony in the 2019 GRC proceeding to reflect the impact of the TCJA soon after SoCalGas had completed its analysis of the impact.[4] The comprehensive changes to the federal tax law under the TCJA and the uncertainties in some portions of the new law required considerable time for SoCalGas to analyze and calculate the TCJA's impact. During the Prehearing Conference held on January 10, 2018, the Commission directed SoCalGas to serve supplemental testimony on tax issues by April 6, 2018, as reflected in the Scoping Memo.

On March 2, 2018, CPUC Energy Division Director Edward Randolph issued a letter (the ED Letter) to several California utilities, including SoCalGas, regarding the implementation of the TCJA. The ED Letter instructed the utilities to "carry out the actions described in . . . this letter, thus providing expeditious rate relief with a maximum of procedural efficiency." The ED Letter addressed the Sempra Utilities – SoCalGas and San Diego Gas & Electric (SDG&E) – as follows:

> Sempra's consolidated TY 2019 GRC is currently in progress (A.17-10-007/A.17-10-008). Rates for attrition year 2018 were adopted in D.16-06-054, which also directed SoCalGas and SDG&E to each establish a Tax Memorandum Account to capture the revenue requirement impact of future tax law changes, such as the TCJA.
>
> ***TCJA Implementation:*** Since Sempra's TY 2019 GRC is currently open, Sempra should follow the rulings of the presiding officer in that proceeding and submit additional TCJA testimony and a revised TY 2019 Results of Operations (RO) model incorporating impact of the TCJA as directed. This will allow the Commission to determine the most effective way to return the TCJA benefits to customers.
>
> Sempra should also follow instructions of the presiding officer regarding the need for any filings in that same GRC regarding the TCJA-related balance in the Tax Memorandum Account accumulated through 2018.

Consistent with the instructions in the Scoping Memo and the ED Letter, SoCalGas is providing this revised Tax testimony to discuss and reflect the impact of the TCJA for

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[4] Application (A.) 17-10-007 et. al, Prehearing Conference Statement of San Diego Gas & Electric Company and Southern California Gas Company, January 5, 2018, at 7.

SoCalGas' 2019 TY. SoCalGas also made the following updates to the 2019 Results of Operations Model (RO Model) to reflect the impact of the TCJA on SoCalGas' 2019 TY:[5]

- Changed the federal corporate tax rate from 35% to 21% for the 2018 and 2019 tax years. This change is discussed in more detail in Section IV.B.1 below.[6]

- Re-measured the accumulated federal deferred income tax (AFDIT) balance as of January 1, 2018 to reflect the new federal corporate tax rate of 21%. The excess deferred taxes, which represents the difference between the AFDIT balance at the prior 35% rate and the AFDIT balance at the new 21% rate, will be refunded to ratepayers in the manner prescribed by the TCJA. The reduction to AFDIT related to the TCJA is offset in the RO Model by a corresponding regulatory liability that reduces rate base, so there is no net impact to rate base from the re-measurement of deferred taxes on January 1, 2018. This change is discussed in more detail in Section IV.C.3 below.

- Increased the ARAM adjustment for 2018 and 2019 to reflect the TCJA's requirement to return plant-related excess deferred taxes to ratepayers ratably using the ARAM calculation as described in the TCJA. This change is discussed in more detail in Section IV.C.3 below.

- Changed the calculation of bonus depreciation to reflect the elimination of the bonus depreciation deduction for regulated utilities. This change is discussed in more detail in Section IV.C.1 below.

- Eliminated the deduction for transportation fringe benefits provided to employees beginning in 2018. This change is discussed in more detail in Section IV.B.2 below.

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[5] While 2018 is an attrition year of SoCalGas' last GRC cycle (TY 2016) and out of scope of the instant proceeding, the updates to the 2019 RO Model include changes to the 2018 forecasted year to reflect the TCJA.

[6] To fully incorporate the impact of the TCJA as instructed by the ED Letter, SoCalGas updated the Energy Division's computation of the repairs deduction rate base adjustment, set forth in SoCalGas' 2016 GRC Decision (D.16-06-054 at Appendix B), by changing the federal corporate tax rate for 2018 through 2038. The repairs deduction rate base adjustment was calculated based on "future tax expense" to ratepayers for the 2016 – 2038 tax years (D.16-06-054 at 192). Therefore, if the tax rates used in the schedule for 2018 and subsequent years are not updated to reflect the TCJA, the calculated future tax expense to ratepayers will reflect an incorrect corporate tax rate for the 2018 – 2038 tax years. The details of SoCalGas' revised computation are provided in my supplemental workpapers (Exhibit SCG-37-WP/SDG&E-35-WP-S). In addition, the RO Model has been updated to reflect the re-calculated repairs deduction rate base adjustment, which reflects the corporate tax rate change under the TCJA and the most current cost of capital percentages authorized by in Commission in D.17-07-005, effective beginning in 2018.

In addition, as directed in the ED Letter, SoCalGas will track the impact of the TCJA through 2018 in its TMA[7] and will follow the instructions of the presiding officer in this proceeding regarding the need for any filings in this GRC regarding the prior rate cycle. In the meantime, as discussed in the Supplemental Testimony of Rae Marie Yu (Exhibit SCG-42-S), SoCalGas is requesting a sub-account in the TMA to specifically track the impacts of the TCJA and to provide a discrete disposition for the balance that is being tracked in the TMA related to the TCJA through 2018. SoCalGas will provide a forecast of impacts of the TCJA through 2018 and proposes to provide such forecast in its Update Testimony filing in this proceeding if the sub-account has been established by that time.[8] SoCalGas looks forward to working with the Commission, Administrative Law Judge Lirag, and parties to determine the best method for returning to its customers the benefits of the reduced tax expense through 2018 related to the TCJA.

II. PAYROLL TAXES

A. Introduction

The purpose of this section is to provide an estimate of SoCalGas' 2019 payroll tax expenses, and to describe the methodology used to develop SoCalGas' estimate.

B. Discussion

Payroll taxes were estimated by applying a tax rate on TY 2019 O&M and capital labor covered under this filing up to a maximum wage base. Payroll taxes are paid by both the employee and the employer. The following discussion relates to the employer's payroll tax liability.

1. Federal Insurance Contributions Act

Federal Insurance Contributions Act (FICA) taxes, also referred to as social security taxes, are composed of two pieces: (1) the Old-Age, Survivors, and Disability Insurance

[7] Similar to the TMA results for 2017, the 2018 results of the TMA will not be known until the incurred amounts are final, which will occur when SoCalGas files its federal and California 2018 income tax returns. SoCalGas expects to file those tax returns in October 2019.

[8] As of the date of this Second Revised Testimony, SoCalGas has not finalized its forecast of the TCJA's impacts through 2018. This is primarily due to SoCalGas' need to prioritize its available tax resources to focus on preparing its revised 2019 GRC testimony to reflect the impacts of TCJA to 2019 and subsequent years to meet the April 6, 2018 deadline set forth in the Scoping Memo. Additionally, 2018 is an attrition year for SoCalGas' 2016 GRC, which creates some unique challenges in updating the 2016 RO Model to reflect the impact of the TCJA for 2018. SoCalGas continues to diligently work through and resolve those challenges related to the 2016 RO Model.

(OASDI) and (2) the Hospital Insurance (HI or Medicare). For 2016, the OASDI tax rate was 6.2% of wages up to a maximum wage base of $118,500. The Medicare tax rate was 1.45% of wages with no maximum wage base. Based on rate schedules contained in the 2017 Annual Report published by the Social Security Administration (2017 Annual Report), the employer's portion of the OASDI and Medicare tax rates have been at current levels since 1990 and are not expected to change through 2019 based on currently enacted law.[9] The OASDI wage base is $127,200 for 2017 and is projected to increase to $130,500 for 2018 and $135,600 for 2019 based on data reported in the 2017 Annual Report.[10]

2. Federal Unemployment Tax Act

The Federal Unemployment Tax Act (FUTA) tax rate was 2.4% for 2016 and 2.7% for 2017 on wages up to $7,000. Based on currently enacted law, the FUTA tax rate is expected to decrease to 0.6% for 2018 and 2019. The FUTA wage base is not expected to change through 2019.

3. California State Unemployment Insurance

The California State Unemployment Insurance (SUI) is composed of two pieces: (1) the Unemployment Insurance (UI), and (2) the California Employment Training Tax (CET). The 2016 UI tax rate was 3.1% on wages up to $7,000. The CET tax rate was an additional 0.1% on wages up to $7,000. The UI rate decreased to 3% for 2017. Based on currently enacted law, the UI tax rate is expected to remain at 3.0% for 2018 and 2019. The CET tax rate and wage bases for SoCalGas are not expected to change through 2019.

4. Methodology Used to Estimate Tax Expense

Payroll taxes are a function of taxable wages and applicable tax rates. The computation of the estimated payroll taxes begins with the 2016 taxable wages stratified into salary increments. The annual wage base in effect for the year for each type of payroll tax was applied to total wages to ensure that wages up to, but not exceeding, the wage base cap were subject to the tax. Thus, wages up to the salary increment where the annual wage is closest to the wage

[9] *See* Table VI.G1, Payroll Tax Contribution Rates for the OASDI and HI Programs, 2017 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds.

[10] *See* Table V.C1, 2017 Annual Report. If the projected OASDI wage bases change in the 2018 Annual Report when that report is issued, and if such changes would cause a material change to forecasted payroll taxes for 2019, SoCalGas will update its 2019 payroll tax forecast in its Update Testimony filing (consistent with SoCalGas' approach in prior GRCs).

base cap are subject to the tax. Wages above the wage base cap for any particular type of payroll tax were derived from multiplying the number of employees in each stratum above the cap by the wage base cap. The resulting taxable wages for each tax type were totaled and the applicable statutory tax rate was then applied to the total taxable wages. The Medicare portion of the FICA tax is computed without respect to a wage base since all wages are subject to that tax. A companywide composite tax rate was computed based on total forecasted payroll taxes using the above methodology divided by total forecasted wages. The composite payroll tax rate for each year was applied to labor dollars applicable to this filing to determine the employer's payroll tax expense.

C. Summary of Estimated Payroll Taxes

Table SCG-RGR-1 below summarizes the amount of payroll taxes on all non-capitalized wages applicable to this filing.

Table SCG-RGR-1
Summary of Estimated Payroll Taxes
($ in Thousands)

Line No.	*2016 Recorded*	*2017 Forecast*	*2018 Forecast*	*2019 Test Year*
1	35,165	41,706	43,448	48,831

D. Results

The increase in payroll taxes from 2016 to 2019 reflects the impacts of staffing level changes presented by other witnesses in their direct testimonies, the impact of labor cost escalation on those changes, and the increase in the composite payroll tax rate resulting from the OASDI wage base increase as discussed above.

III. AD VALOREM TAXES

A. Introduction

The purpose of this section is to provide an estimate of SoCalGas' ad valorem taxes that will be incurred during TY 2019, and to describe the methodology used to develop the estimate.

B. Discussion

Ad valorem taxes are a function of the assessed value of property and a tax rate applied to that value. Property owned and used by public utilities as of January 1 (the lien date) each year is re-assessed to its full market value by the California State Board of Equalization (SBE). By definition, ad valorem taxes are based on the value of the property being taxed. Appraisers have developed various generally accepted indicators of value that are correlated to yield an estimation of the market value of the property being assessed. The primary indicator of value for regulated public utility property is the Historical Cost Less Depreciation (HCLD) indicator, and a secondary indicator is the Capitalized Earnings Ability (CEA).

HCLD is the primary indicator of value for closely rate-regulated property because it approximates rate base. HCLD is equal to the estimated cost of property which is subject to assessment by the SBE less the accumulated depreciation taken on the property. Historical cost consists of the original cost of plant balances on the January 1 lien date, plus construction work-in-progress, materials and supplies on hand to operate the plant, and non-current (cushion) gas stored underground. Adjustments are made to add the value of possessory interests held by the utility on government-owned property and to deduct non-taxable licensed motor vehicles, software, leasehold improvements, business inventories, and other property not subject to ad valorem taxes. Finally, the HCLD indicator is adjusted by deducting the accumulated deferred federal income taxes on taxable property.

The CEA, or the income approach to value, is designed to recognize the concept that the value of business property is closely related to its ability to generate income. The CEA indicator is used when the property being appraised is purchased in anticipation of receiving income (*i.e.*, rental property), and the actual future income stream can be reliably forecast, or a hypothetical income stream can be estimated by comparison to other similar properties. The CEA is the preferred approach for the appraisal of properties when reliable sales data are not available or the cost approach does not yield reliable results. The CEA is a secondary indicator of value for public utility property because the income of public utility property is limited by regulation, and comparison to the income stream from similar properties is limited.

SoCalGas has filed its property statements with the SBE for the 2016 and 2017 lien dates. The property statements form the basis of the appraisals to set the value of SoCalGas' property for the 2016-2017 and 2017-2018 fiscal years. The SBE reports the value of property subject to ad valorem tax annually on the "Notice of Unitary Appraised Value," which SoCalGas has received for the 2016 and 2017 lien dates. In correlating the value indicators calculated by the SBE from information contained in the property statement, the SBE applied a weighting of 75% to the HCLD indicator and 25% to the CEA indicator to derive the total appraised valuation of

SoCalGas' unitary property.[11] Added to the unitary value of SoCalGas' property is the value of SoCalGas' non-unitary property.[12] In estimating ad valorem taxes for ratemaking purposes, adjustments were made to exclude taxes resulting from: (a) the assessment of non-utility property since it is not included as an operating expense, and (b) Construction Work in Process (CWIP), which is capitalized rather than directly charged to ad valorem tax expense.

The SBE has followed the same assessment methodology for several years; consequently, SoCalGas followed this methodology to estimate the assessed value for unitary property and the resulting ad valorem tax expense estimate for TY 2019.

The tax rate used to estimate California ad valorem taxes is the basic statewide tax rate of 1% established under Proposition 13 plus an additional rate component of 0.2877%, which is a composite rate derived from dividing taxes paid to local jurisdictions by the total assessed value of property in all voter approved local assessment districts as allowed under Proposition 13. The escalation in the rates from 2016 to 2019 represents the average historical rate of increase in local tax rates over the most recent five-year period. The estimated ad valorem tax expense for TY 2019 is comprised of the second installment payment from fiscal year 2018-2019 plus the first installment payment for fiscal year 2019-2020.

C. Summary of Estimated Ad Valorem Tax Expenses

Table SCG-RGR-2 below summarizes SoCalGas' estimated ad valorem tax expenses.

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[11] Unitary property is property owned or used by a utility that the SBE has determined is used in SoCalGas' operating business. The weight given to the CEA and HCLD indicators by the SBE can be derived mathematically by correlating the value indicators to the final value.

[12] Non-unitary property is property owned or used by the utility that the SBE has determined is not used in SoCalGas' operating business.

TABLE SCG-RGR-2
Southern California Gas Company
Summary of Estimated Ad Valorem Tax Expenses
($ in Thousands)

Line No.	*Description*	*2016 Recorded*	*2017 Estimated*	*2018 Estimated*	*2019 Test Year*
1	Taxable Plant in Service	12,457,129	13,187,985	14,445,660	15,588,980
2	Taxable Reserve for Depreciation	(6,167,078)	(6,434,066)	(6,736,636)	(7,106,825)
3	Taxable Net Plant	6,290,051	6,753,919	7,709,024	8,482,155
4	Taxable Reserve for Def. Inc. Tax	(1,208,446)	(1,281,395)	(1,407,614)	(793,425)
5	Adjustment for Income Approach	(24,653)	(26,550)	(30,571)	(37,301)
6	Assessed Value - Non-Unitary	41,632	44,835	51,625	62,991
7	Net Assessable Value	5,098,584	5,490,809	6,322,465	7,714,421
8	Ad Valorem Tax Rate	1.2876686%	1.2966182%	1.3055679%	1.3145176%
9	Ad Valorem Tax - Fiscal Year	65,653	71,195	82,544	101,407
10	Other Adjustments	3	3	3	3
	Fiscal Year				
11	Total Operating Ad Valorem Tax	65,656	71,198	82,547	101,410
12	Capitalized Ad Valorem Tax	(7,695)	(6,967)	(7,752)	(8,627)
13	Net Operating Ad Valorem Tax	57,961	64,231	74,795	92,783
	Calendar Year (Note 1)				
14	Total Operating Ad Valorem Tax	59,509	68,141	76,286	91,393
15	Capitalized Ad Valorem Tax	(7,036)	(6,457)	(6,304)	(8,027)
16	Net Operating Ad Valorem Tax	52,473	61,684	69,982	83,366

(Note 1) - Calendar year total operating ad valorem tax = ½ of the current fiscal year total ad valorem tax plus ½ of the prior fiscal year total ad valorem tax.

D. Results

The changes from 2016 to 2019 are the result of changes in plant and depreciation balances presented by other witnesses in their direct testimonies and the expected escalation in the tax rate for local assessments as discussed above.

IV. INCOME TAXES

A. Introduction

The purpose of this section is to provide an estimate of SoCalGas' income tax expense for TY 2019, and to describe the assumptions and methodology used to calculate income tax expense. This section also presents the 2016 results of the TMA.

B. Discussion of Income Tax Expense

1. Methodology

SoCalGas operating income is subject to federal income tax and the California Corporation Franchise Tax (CCFT). Income tax expense is a function of cost-of-service amounts and capital expenditures adopted by the CPUC, as adjusted to comply with income tax rules. Accordingly, the calculation of ratemaking income taxes is dependent upon federal and state tax laws, prior CPUC decisions with general applicability to all utilities, and decisions with specific reference to SoCalGas.

Consistent with CPUC Decision (D.) 84-05-036 issued in Order Instituting Investigation (OII) 24, the income tax estimates contained in this section are based on SoCalGas' stand-alone taxes, not on an allocation of tax expense from Sempra Energy, the parent company of SoCalGas.[13]

Another issue considered by the CPUC in OII 24 was whether expenses not borne by customers should be included as income tax deductions in computing estimated TY income tax expense. The CPUC stated that it had consistently calculated income taxes for ratemaking purposes based on the cost of service developed from authorized expenses.[14] The CPUC also found that if they were to include expenses not subject to rate recovery as a deduction in calculating taxable income, stockholders would be penalized by a reduction in their net income equal to the full amount of the expenditures, because they would have no offsetting tax deduction.[15] The Commission concluded that their method of excluding expenses not borne by customers in the calculation of TY income tax expense is reasonable and should continue.[16] As such, SoCalGas follows this conclusion of law from OII 24 in this Gas Rate Case (GRC) proceeding.

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[13] 1984 Cal. PUC LEXIS 1325 at *57-58 (Finding of Fact #12); 15 CPUC 2d 42.
[14] *Id*. at *15.
[15] *Id*. at *16-18.
[16] *Id*. at *62 (Conclusion of Law 2).

The estimates contained in this section were calculated using current federal and state tax laws enacted through the date of this testimony. SoCalGas has not attempted to forecast any future changes in tax law in the income tax calculations. For 2016 and 2017, SoCalGas has utilized the federal and state statutory tax rates of 35% and 8.84%, respectively, in developing its estimate of federal and state income tax expense for those years. Pursuant to the change in the federal corporate tax rate beginning in 2018 under the TCJA, SoCalGas has utilized the current federal and state statutory tax rate of 21% and 8.84%, respectively, in developing its estimate of federal and state income tax expense for 2018 and 2019.

State income tax expense has been computed by reducing operating income by operating expenses, including property taxes and payroll taxes, and making certain permanent and flow through tax adjustments for differences in the book and state tax treatment of items of income and expense (Schedule M adjustments) as explained in more detail later in this section. Consistent with the CPUC policy discussed in D.93848,[17] a flow through accounting methodology was utilized in estimating state tax expense.[18]

Federal income tax expense has been computed by reducing operating income by operating expenses, including property taxes, payroll taxes, and prior year state taxes, and making tax adjustments for differences in the book and federal tax treatment of certain items of income and expense (Schedule M adjustments), also explained in more detail later in this section.

Where required, SoCalGas has followed the normalization rules contained in Internal Revenue Code Section (IRC) § 168 and Treasury Regulations Section (Treas. Reg.) § 1.167(l)-1 in computing federal income tax expense.[19] Accordingly, federal tax depreciation on post-1980 vintage assets has been "normalized" by using a book life and method to calculate tax depreciation. Consistent with CPUC policy, where normalization is not required by the IRC, SoCalGas generally has flowed through tax deductions. For example, tax depreciation on pre-1981 vintage assets has been flowed through as an adjustment to federal tax expense as required by D.93848.[20]

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[17] 1981 Cal. PUC LEXIS 1240; 7 CPUC 2d 332.
[18] Flow-through accounting treats temporary differences between recognition of expenses for book purposes and their tax return treatment as current adjustments to the revenue requirement.
[19] Normalized tax accounting follows the book treatment for items of income and expense in the revenue requirement calculation.
[20] 1981 Cal. PUC LEXIS 1240; 7 CPUC 2d 332.

Tax expense based on income has been reduced by the amortization of deferred Investment Tax Credits (ITC) generated in prior years in accordance with SoCalGas' election under applicable tax law[21] to ratably flow through the ITC benefit as a reduction to ratemaking tax expense at a rate not to exceed the book life of the property that generated the ITC. This application conforms to the treatment of deferred ITC amortization mandated by D.88-01-061[22] and is the same treatment employed by SoCalGas in prior rate cases. SoCalGas has a small portion of deferred ITC that reduced rate base, pursuant to an election made under applicable law[23] by a predecessor company, Pacific Lighting Gas Supply Company (Pacific Lighting), which merged with SoCalGas in November 1985. As a successor in interest, SoCalGas continues to amortize deferred ITC generated by Pacific Lighting as a ratable restoration to rate base.

SoCalGas' federal income tax expense has been reduced by the amortization of remaining excess deferred federal income taxes resulting from a reduction in the federal income tax rate from a high of 41% prior to the Tax Reform Act of 1986 (TRA 86) to the current 21% under the TCJA beginning in 2018, utilizing the Average Rate Assumption Method (ARAM) as required by Internal Revenue Service (IRS) normalization rules and mandated by D.88-01-061.[24] Additionally, ARAM is the required method for amortizing plant-related excess AFDIT resulting from the tax rate reduction under the TCJA.[25] Only a small amount of excess AFDIT remains from the decrease in tax rate under TRA 86. The ARAM amount increases significantly beginning in 2018, due to the reduction in the federal corporate income tax rate from 35% to 21% under the TCJA. The ARAM rules and methodology required under the TCJA are discussed in more detail in Section IV.C.3 below.

TRA 86 adopted rules regarding capitalization of construction period interest for long-lived assets that have an extended construction period. These rules were codified in IRC § 263A. For book and ratemaking purposes, construction period interest is capitalized through an allowance for funds used during construction (AFUDC). While similar in concept, there are specific differences between the book and tax treatment of construction period interest. As in

[21] SoCalGas' election under former IRC § 46(f)(2).
[22] 1988 Cal. PUC LEXIS 102; 27 CPUC 2d 310.
[23] Pacific Lighting's election under former IRC § 46(f)(1).
[24] 1988 Cal. PUC LEXIS 102 at *95-96.
[25] TCJA Section 13001(d)(3)(B).

prior rate cases, for tax purposes, SoCalGas follows the rules in IRC § 263A in this filing with respect to the treatment of construction period interest.

As prescribed by the CPUC in D.84-05-036, SoCalGas used the statutory federal tax rate of 35% for 2016-2017 and 21% for 2018-2019, and the statutory state tax rate of 8.84% in development of the net-to-gross multiplier used to gross-up tax expense to a revenue requirement.[26]

2. Schedule M Items and Other Specific Tax Deductions

SoCalGas made several adjustments to book income in the form of Schedule M adjustments to arrive at taxable income. In addition, there are other types of deductions permitted under the IRC that have been incorporated into the computation of SoCalGas' tax expense, as discussed below.

Fixed Charges – Operating. This adjustment represents the interest expense accrued on debt used to finance rate base. The deduction is computed using rate base and the authorized weighted-average cost of long-term debt. The CCFT interest deduction is based on rate base net of deferred ITC (as ITC is not available for CCFT purposes).

Preferred Dividend Deduction. IRC § 247 allows a deduction for dividends paid on preferred stock issued prior to October 1, 1942. A deduction is also allowed for dividends on preferred stock issued after October 1, 1942 if the preferred stock replaced other preferred stock or bonds issued before October 1, 1942. A portion of SoCalGas' preferred stock dividends qualify for deduction, which is a permanent difference between the book and tax treatment. SoCalGas has flowed through this deduction.

Fiscal Year/Calendar Year Property Tax Adjustment. An adjustment is made to add back book calendar-year property tax expense and deduct fiscal-year property tax expense as allowed by federal and state tax law. Consistent with CPUC policy, this deduction is flowed through in the calculation of income tax expense.

Prior Year CCFT. Federal law allows a deduction for state income taxes paid. In California, this is the CCFT deduction. For ratemaking purposes, D.89-11-058[27] specifies that the allowable deduction is the prior years' CPUC-adopted CCFT, not the current year CCFT.

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[26] 1984 Cal. PUC LEXIS 1325 at *62-63 (Conclusion of Law 9).
[27] 1989 Cal. PUC LEXIS 815 at *34 (Conclusion of Law 1); 33 CPUC 2d 495.

Since there is, as yet, no CPUC-adopted CCFT, SoCalGas has used the prior year's CCFT estimate in calculating federal tax expense for TY 2019.

Internally-Developed Software. For financial accounting purposes, software expenditures are capitalized and amortized to expense over various lives. For tax purposes, a current-year deduction is allowed under IRC § 174 for internally-developed software expenditures.[28] SoCalGas has deducted internally developed software expenditures as a flow-through deduction pursuant to D.84-05-036.[29] IRC § 167(f)[30] requires capitalization of un-modified, or "canned" software. SoCalGas applies normalized tax accounting treatment to expenditures for canned software pursuant to D.84-05-036.

Federal Tax Depreciation. Federal tax depreciation on post-1980 vintage property is governed by the normalization rules described earlier. Differences between book and tax depreciation resulting from the different methods and lives used to compute book and tax depreciation are normalized. Federal tax return depreciation on pre-1981 vintage property is flowed through as a deduction in the computation of federal taxable income, as is depreciation attributable to differences in the basis used to depreciable property for book and tax purposes.

State Tax Depreciation. California did not adopt the federal accelerated depreciation lives and methods or the normalization requirements enacted by the Economic Recovery Tax Act of 1981 (ERTA) and the TRA 86. Accordingly, there is no requirement to normalize state tax depreciation; therefore, SoCalGas flows through the state tax depreciation in excess of the amount deducted for book purposes. SoCalGas' state tax depreciation is calculated using the Asset Depreciation Range Method (ADR) prescribed by the IRS prior to 1981, which utilizes double declining balance depreciation switching to a straight-line method when book depreciation exceeds the double declining balance method.

Federal Cost of Removal. SoCalGas follows the guidance in IRS Revenue Ruling 2000-7,[31] which provides a current tax deduction for actual costs to remove assets retired from service in the year that those costs are incurred. For book purposes, estimates of such costs are

[28] The 2019 tax deduction for internally-developed software is a function of the forecasted spend on internally-developed software in TY 2019. Spend data is forecasted by capital witnesses in the rate base module and the tax module pulls in the forecasted spend data from the rate base module.
[29] 1984 Cal. PUC LEXIS 1325.
[30] IRC § 167(f) required capitalization of un-modified software purchased after August 10, 1993.
[31] 2000-1 C.B. 712.

capitalized and depreciated over the life of the assets. Thus, there is a timing difference between tax and book. To be consistent with the treatment of property that is being depreciated under the Accelerated Cost Recovery System (ACRS) or the Modified Accelerated Cost Recovery System (MACRS) as described above, SoCalGas normalizes the costs to remove those assets for federal tax purposes and flows through the federal removal costs only on pre-1981 vintage assets retired from service. This approach is consistent with prior GRCs.

State Cost of Removal. California did not adopt the federal ACRS or MACRS depreciation systems, choosing instead to remain on the ADR system. Accordingly, SoCalGas flows through removal costs for CCFT purposes irrespective of the vintage of the underlying assets per D.84-05-036.[32] This treatment is consistent with prior GRCs.

Repairs Deduction. The Schedule M adjustment for the repairs deduction represents the difference between expenditures that are permitted to be deducted as repairs for tax purposes and those same expenditures that are required to be capitalized for financial reporting purposes. SoCalGas has flowed through the tax benefits associated with its projected repairs deduction to ratepayers for TY 2019 for both federal and California purposes in accordance with D.93848.

Employee Transportation Benefits. Prior to the enactment of the TCJA, employers generally were allowed a deduction for the costs associated with providing transportation fringe benefits to its employees, such as parking and commuter rail costs, under IRC Section 274. The TCJA amended IRC Section 274 effective January 1, 2018 to eliminate the deduction for expenses incurred in providing any transportation to employees, or any payment or reimbursement for transportation fringe benefits to employees, except as necessary to ensure the safety of the employee.[33] SoCalGas continues to provide transportation fringe benefits to its employees; however, since such costs are no longer deductible under the TCJA, SoCalGas must add back these costs in computing taxable income beginning in 2018.

Tax Credits. SoCalGas has reflected an offset to tax expense for allowable federal and state tax credits allowed under current law. SoCalGas has also reflected a “credit addback” where required in computing taxable income. As a general rule, a taxpayer cannot claim both a deduction and a credit for the same item of expense. Therefore, SoCalGas has added the amount of credits claimed back to taxable income to reverse the corresponding tax deductions.

[32] 1984 Cal. PUC LEXIS 1325 at *59 (Finding of Fact 23).
[33] TCJA Section 13304(c).

C. Discussion of Deferred Taxes

The accumulated deferred federal income tax (ADFIT) resulting from the difference between normalized tax depreciation computed using a book life and book method and the comparable tax depreciation computed using ACRS or MACRS has been included as an adjustment to rate base in this GRC (see the testimony of Patrick D. Moersen (Exhibit SCG-35-2R), for a discussion of rate base). SoCalGas' treatment of deferred taxes is in accordance with IRC § 168(i)(9), Treas. Reg. § 1.167(l)-1, and numerous related IRS rulings that taken together constitute the "tax normalization" requirements.

All current law has been followed in the development of deferred federal income taxes. Accumulated deferred taxes for TY 2019 were developed on a monthly basis and prorated in accordance with the normalization requirements in Treas. Reg. § 1.167(l)-1(h)(6)(ii).[34]

1. Bonus Depreciation

a. Extension under the PATH Act

On December 18, 2015, President Obama signed into law The Protecting Americans from Tax Hikes Act of 2015 (the PATH Act).[35] One of the provisions of the PATH Act was an extension of the bonus depreciation rules, which has deferred tax implications for SoCalGas' TY 2019 forecasts.

The bonus depreciation rules allow taxpayers to immediately expense a specified percentage of qualifying property placed into service in a particular year, rather than requiring the taxpayer to depreciate the full amount of the property over multiple years. Unlike previous extensions that generally extended bonus depreciation for only one year, the PATH Act extended bonus depreciation to eligible property placed into service between January 1, 2015 and December 31, 2019,[36] and for costs incurred before January 1, 2020 attributable to eligible long

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[34] The method prescribed by Treas. Reg. § 1.167(l)-1(h)(6)(ii) is to be used when rates are set on a projected future period. Tax expense must be computed using a rate and method consistent with the rate and method used for book depreciation. The deferred tax reserve that reduces rate base must be computed using the average of the beginning-of-year balance plus a prorated end-of-year balance. The prorated end-of-year balance was computed assuming that additions to the deferred tax balances are credited ratably at the end of each month throughout the year.

[35] Pub. L. No. 114-113, H.R. 2029.

[36] IRC § 168(k).

production period property (LPPP)[37] that is placed into service before January 1, 2021.[38] The bonus depreciation rules expire generally on December 31, 2019 (and expire on December 31, 2020 for eligible LPPP).

The bonus depreciation percentage for eligible property placed in service in 2015-2017 is 50%.[39] The percentage decreases to 40% for 2018 and decreases further to 30% for 2019.[40] Special rules allow qualifying LPPP to receive a one-year extension on the bonus depreciation phase-out rates. Therefore, for qualifying LPPP, the 50% bonus depreciation rate applies to property placed in service in 2018, the 40% rate applies to property placed in service in 2019, and the 30% rate applies to property placed in service in 2020.[41]

The bonus depreciation rules contained in the PATH Act apply to the same types of property eligible for bonus depreciation under prior law. Property eligible for bonus depreciation is generally limited to business property with a tax recovery period of 20 years or less and only if the original use of the property commences with the taxpayer.

For ratemaking purposes, bonus depreciation allowed by the PATH Act is subject to the tax normalization rules contained in IRC § 168 and Treasury Regulations under former IRC § 167. The ratemaking effect of the PATH Act is to increase federal tax return depreciation for 2015 through 2019 above the regular tax depreciation provided by the federal MACRS depreciation system. The extra bonus tax depreciation allowed by the PATH Act creates additional deferred taxes equal to the extra bonus depreciation multiplied by the federal income tax rate. The impact of the PATH Act's extension of bonus depreciation on SoCalGas' 2015 and 2016 tax years was reflected in D.16-06-054 (SoCalGas' 2016 GRC Decision);[42] therefore, the additional deferred taxes created by the PATH Act's extension of bonus depreciation are reflected in the accumulated deferred tax balances for purposes of calculating rate base.

Except in the case of certain qualified self-constructed assets placed in service in 2005, bonus depreciation has not been calculated on property placed in service between January 1, 2005 and December 31, 2007, when bonus depreciation was not allowed. The residual impact of

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[37] LPPP is defined as property with a MACRS tax depreciation life of at least 10 years, a cost exceeding $1 million, and a construction period of one year or more. IRC § 168(k)(2)(B)(i).
[38] IRC § 168(k)(2)(B).
[39] IRC § 168(k)(1)(A).
[40] IRC § 168(k)(6).
[41] *Id.*
[42] *See* D.16-06-054 at 213.

bonus depreciation taken on qualified property placed in service in prior periods is reflected in the accumulated deferred income tax balances for 2016-2019.

b. Changes to the Bonus Depreciation Rules under the TCJA

The bonus depreciation rules under the TCJA supersede the bonus depreciation rules under the PATH Act for qualified property acquired pursuant to a written binding contract and placed in service after September 27, 2017.[43] For such property, the TCJA generally increases the bonus depreciation allowance to 100 percent through the end of 2022.[44] However, the TCJA also specifies that bonus depreciation is not available for assets acquired in the trade or business of the furnishing or sale of:

> (I) electric energy, water, or sewage disposal services, (II) gas or steam though a local distribution system, or (III) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, by a public service or public utility commission or other similar body of any State or political subdivision thereof, or by the governing or ratemaking body of an electric cooperative."[45]

Accordingly, the TCJA eliminates the bonus depreciation deduction for regulated utilities, such as SoCalGas.

The TCJA includes a transition rule applicable to property acquired pursuant to a written binding contract <u>on or before</u> September 27, 2017, but placed in service <u>after</u> such date. Under the transition rule, the bonus depreciation rates and rules under the PATH Act still apply.[46] Thus, for property subject to the transition rule, qualified property placed in service in 2017 is eligible for 50% bonus depreciation, property placed in service in 2018 is eligible for 40% bonus depreciation, and property placed in service in 2019 is eligible for 30% bonus depreciation.[47]

While it is clear that the TCJA eliminates the bonus depreciation deduction for regulated utilities on a going forward basis, the precise manner in which the transition rule should be applied remains unclear, in particular the application of the "acquisition" requirement. The IRS and the United States Treasury Department (Treasury) recognized that additional guidance is

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[43] TCJA Section 13201(h)(1).
[44] TCJA Section 13201(a)(2).
[45] TCJA Sections 13201(d)(9)(A) and 13301(a).
[46] TCJA Section 13201(a)(3).
[47] *Id.*; I.R.C. § 168(k)(8)(A) and (B).

needed for the TCJA's new bonus depreciation rules by adding "Guidance on new § 168(k)" as a priority project in the most recent update to the IRS and Treasury's 2017-2018 Priority Guidance Plan (Guidance Plan).[48] The updated Guidance Plan "reflects 29 additional projects, including those that have become near term priorities as a result of the Tax Cuts and Jobs Act legislation."[49] The Guidance Plan lists the priority guidance projects that the IRS and Treasury "hope to complete during the twelve-month period from July 1, 2017 through June 30, 2018."[50] Thus, it is possible that the IRS and Treasury will release additional guidance for the new bonus depreciation rules under the TCJA by June 30, 2018, although there is no requirement for the IRS and Treasury to meet this target date. Accordingly, it is uncertain if or when additional guidance under the TCJA's bonus depreciation rules will be released.

There is no consensus as yet among utilities or accounting firms on the application of the transition rules. SoCalGas has reviewed the statutory language of the new bonus depreciation rules under the TCJA, discussed the issue with its outside advisors, and participated in industry group discussions regarding the bonus depreciation rules. After its analysis and its discussions with outside experts and its utility peers, SoCalGas has concluded that the best interpretation of the new rules is to follow the statutory language as written, and not to assume that any forthcoming guidance from the IRS or Treasury will narrow, expand, or otherwise change the application of the transition rules, or any other bonus depreciation rules under the TCJA. Such assumption is consistent with SoCalGas' overall methodology on income taxes, which is to apply the current tax law without attempting to predict potential future changes in tax law. Accordingly, consistent with the language of the TCJA, SoCalGas has not taken bonus depreciation on any property that was placed in service after September 27, 2017 and was not acquired pursuant to a written binding contract on or before such date.[51]

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[48] Department of the Treasury 2017-2018 Priority Guidance Plan, 2nd quarter update (Feb. 7, 2018).
[49] *Id.*
[50] *Id.*
[51] If the IRS or Treasury issue guidance clarifying the application of the bonus depreciation rules under the TCJA, and such guidance differs from SoCalGas' interpretation of the rules, SoCalGas will revise its calculation of bonus depreciation to be consistent with such guidance. SoCalGas proposes to reflect any such revised calculation in its Update Testimony, or, alternatively, to track the impact of the revised calculation in its TMA, depending on the timing of when such IRS or Treasury guidance is issued.

2. Contributions-in-Aid-of-Construction

Contributions-in-aid-of-construction (CIAC) are non-refundable contributions collected from utility customers in the form of money – or its equivalent – toward the construction of plant, such as customer-requested relocations. CIAC became taxable under the TRA 86. The CPUC proposed the Maryland Method or Method 5 as acceptable alternatives for the ratemaking treatment of CIAC in D.87-09-026.[52] SoCalGas elected Method 5 to account for the tax impacts of CIAC, and the related income tax component of the CIAC (ITCC) as required by the TRA 86. In accordance with D.87-09-026, SoCalGas has increased rate base for the tax paid on CIAC and its related ITCC received subsequent to February 10, 1987, the date that CIAC became taxable under the TRA 86. The increase to rate base related to CIAC tax impacts is reversed through tax depreciation over the tax life of the constructed property. The increase to rate base related to ITCC tax impacts is reversed through the amortization of ITCC to miscellaneous revenue over the tax life of the constructed property.

ITCC represents the tax gross-up for CIAC. It also became taxable under TRA 86. These tax gross-up amounts reflect the present value of tax paid upon receipt of CIAC, less the future tax benefits to be received through tax depreciation over the tax life of the constructed property. ITCC is included as a reduction to rate base and is amortized to miscellaneous revenue over the tax life of the constructed property as instructed by D.87-09-026.[53]

3. Excess Deferred Taxes Related to the TCJA

SoCalGas has recomputed its AFDIT balances as of January 1, 2018 to reflect the reduction in the federal corporate income tax rate from 35% to 21% under the TCJA. The difference in the AFDIT balance under the old tax rate versus under the new tax rate represents the excess deferred tax reserve created by the TCJA. The TCJA defines the "excess tax reserve" as "(i) the reserve for deferred taxes (as described in section 168(i)(9)(A)(ii) of the Internal Revenue Code of 1986) as of the day before the corporate rate reductions . . . made by this section take effect, over (ii) the amount which would be the balance in such reserve if the amount of such reserve were determined by assuming that the corporate rate reductions provided in this Act were in effect for all prior periods."[54]

[52] 1987 Cal. PUC LEXIS 195; 25 CPUC 2d 299.
[53] 1987 Cal. PUC LEXIS 195; 25 CPUC 2d 299.
[54] TCJA Section 13001(d)(3). The TCJA's reference to IRC Section 168(i)(9)(A)(ii) is to the IRS normalization rules discussed earlier in my testimony.

These excess deferred tax reserves belong to SoCalGas' customers, and SoCalGas will return the excess deferred taxes to its customers in full. But in doing so, SoCalGas must adhere to the timing rules and other requirements under the TCJA. Failure to follow these rules and procedures will result in a normalization violation.[55] The TCJA specifies that utilities may not return the excess AFDIT associated with utility plant assets (excess plant-based AFDIT) more rapidly than ratably over the life of the underlying assets.[56] Specifically, utilities are generally not permitted, in computing costs of service for ratemaking purposes, to refund excess plant-based AFDIT more rapidly or greater than the reductions permitted by the ARAM approach, which requires amortization of the excess tax reserve over the remaining regulatory lives of the property that gave rise to the AFDIT.[57] If a utility's books and records do not contain the vintage data necessary to apply ARAM, the TCJA allows the utility to use an alternative method that amortizes the excess plant-based AFDIT ratably over the remaining average life or composite rate used to compute depreciation for regulatory purposes.[58]

The TCJA defines ARAM as follows:

> The average rate assumption method is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes. Under such method, during the time period in which the timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying – (i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by (ii) the amount of the timing differences which reverse during such period.[59]

ARAM is computed on an asset-by-asset basis. Thus, due to the large number of SoCalGas' plant-related assets, the computation is too complex and detailed to incorporate within the RO Model. SoCalGas instead relies on its tax accounting and depreciation software to compute the ARAM amount for each year.

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[55] TCJA Section 13001(d)(4).
[56] TCJA Section 13001(d)(1).
[57] TCJA Section 13001(d)(3)(B).
[58] TCJA Section 13001(d)(3)(C). SoCalGas has the vintage data needed to compute ARAM and thus does not fall within this exception.
[59] TCJA Section 13001(d)(3)(A).

The requirement to use ARAM applies only to excess deferred taxes on plant-based assets that are subject to the IRS normalization rules (also known as "protected" assets). In SoCalGas' prior rate case proceedings, certain other timing differences related to plant-based assets have been and continue to be treated as normalized differences, even though they fall outside of the IRS definition of normalization. Since these "unprotected" plant-based timing differences have been afforded normalization treatment in prior rate case decisions, SoCalGas proposes that an ARAM methodology should also be used to return these benefits to its customers.

The ARAM rules under the TCJA do not discuss the individual components of plant-based deferred taxes. Thus, there is uncertainty within the utility industry regarding how to treat removal costs for purposes of the ARAM computation. SoCalGas has discussed the issue with its outside advisors and participated in industry group discussions regarding the proper treatment of removal costs in the ARAM calculation. After its analysis and its discussions with outside experts and its utility peers, SoCalGas has concluded that the best interpretation of the ARAM rules under the TCJA is to exclude new removal costs accrued for book purposes after December 31, 2017 from its ARAM calculation.[60] Since ARAM addresses historical excess tax reserves *(i.e.*, pre-2018), SoCalGas' position is that only the depreciation that relates to the recovery of the original cost of those capital expenditures should be included. The depreciation related to recovering new cost of removal is a new timing difference arising after 2017; thus, by definition, it is not a recovery of the original cost basis that gave rise to the historical excess tax reserves from tax accelerated depreciation.

SoCalGas is aware of at least one other utility that is seeking a private letter ruling from the IRS on the issue of whether future removal costs should be excluded from the ARAM calculation. If the IRS issues a private letter ruling on this issue, or if the IRS or Treasury release other guidance on this issue, and such ruling or guidance differs from SoCalGas' position, SoCalGas will recalculate the ARAM adjustment to conform to such guidance. Alternatively, if

[60] SoCalGas' position is consistent with the positions taken on this same issue by both Southern California Edison Company (SCE) and Pacific Gas and Electric Company (PG&E) in their recent submissions to the Commission to address the impact of the TCJA. *See* A.16-09-001, Exhibit SCE-60: Tax Update Testimony; A.13-12-012/Investigation (I.) 14-06-016, Petition for Modification of D.16-06-056 of PG&E to Reflect Tax Changes; A.15-09-001, Petition for Modification of D.16-06-056 of PG&E to Reflect Tax Changes; A.17-11-009, Update Testimony (March 30, 2018).

the Commission believes it is necessary, SoCalGas could request its own private letter ruling from the IRS on this issue. SoCalGas proposes to reflect any such revised calculation of the ARAM adjustment in its Update Testimony, or, alternatively, to track the impact of the revised calculation in its TMA, depending on the timing of when such IRS or Treasury guidance is issued.

D. Summary Tables

The following summary tables reflect the federal and state income taxes applicable to this filing.

TABLE SCG-RGR-3-1
Southern California Gas Company
Calculation of Federal & State Income Taxes
($ in Thousands)

Line No.	*Description*	*2016 Recorded*	*2017 Estimated*	*2018 Estimated*	*2019 Test Year*
1	Total Operating Revenue	2,109,948	2,366,433	2,497,535	2,930,792
2	O&M Expenses	(1,113,196)	(1,280,211)	(1,376,994)	(1,630,042)
3	Taxes Other than Income Taxes	(87,638)	(103,390)	(113,430)	(132,197)
4	Book Income Before Depr. & Income Taxes	909,113	982,833	1,007,112	1,168,553
5	State Tax Adjustments	(774,880)	(934,803)	(956,889)	(1,088,221)
6	Taxable Income	134,234	48,030	50,223	80,332
7	CCFT Rate	8.84%	8.84%	8.84%	8.84%
8	**California Corporate Franchise Tax**	11,866	4,246	4,440	7,101
9	Book Income Before Depr. & Income Taxes (Line 4, above)	909,113	982,833	1,007,112	1,168,553
10	Federal Tax Adjustments	(707,225)	(754,438)	(773,857)	(898,911)
11	Taxable Income	201,888	228,395	233,255	269,642
12	Federal Income Tax Rate	35%	35%	21%	21%
13	Federal Income Tax Before Credits	70,661	79,938	48,984	56,625
14	Investment Tax Credit Amortization	(1,945)	(1,813)	(1,677)	(1,448)
15	Average Rate Assumption Method (ARAM)	(564)	(621)	(12,599)	(14,060)
16	Other	(1,739)	(190)	(79)	(46)
17	**Total Federal Income Tax**	66,413	77,314	34,628	41,071

TABLE SCG-RGR-3-2
Southern California Gas Company
Summary of Income Tax Adjustments
($ in Thousands)

Line No.	*Description*	*2016 Recorded*	*2017 Estimated*	*2018 Estimated*	*2019 Test Year*
	Federal Tax Adjustments:				
1	Tax Depreciation	(338,137)	(356,822)	(383,334)	(440,099)
2	Fixed Charges – Operating	(120,493)	(133,256)	(115,211)	(137,833)
3	Repairs	(127,184)	(140,638)	(159,472)	(162,717)
4	Software Development	(79,050)	(95,504)	(93,257)	(130,107)
5	Cost of Removal	(10,326)	(13,334)	(14,427)	(15,201)
6	Ad Valorem Tax - Fiscal/Calendar	(5,488)	(2,547)	(4,813)	(9,418)
7	Preferred Dividend & Other	(2,228)	(472)	(471)	(471)
8	Disallowed Transportation Fringe Benefits	-	-	1,376	1,376
9	Prior Year Calif. Corp. Franchise Tax	(24,318)	(11,866)	(4,246)	(4,440)
10	Total Federal Tax Adj. (Deduction)	(707,225)	(754,438)	(773,857)	(898,911)
	State Tax Adjustments:				
11	Tax Depreciation	(383,516)	(510,873)	(527,643)	(588,552)
12	Fixed Charges – Operating	(120,184)	(132,995)	(115,049)	(137,699)
13	Repairs	(127,184)	(140,638)	(159,472)	(162,717)
14	Software Development	(79,050)	(95,504)	(93,257)	(130,107)
15	Cost of Removal	(58,008)	(52,391)	(56,687)	(59,728)
16	Ad Valorem Tax - Fiscal/Calendar	(5,488)	(2,547)	(4,813)	(9,418)
17	Preferred Dividend & Other	(1,448)	145	33	-
18	Total State Tax Adj. (Deduction)	(774,880)	(934,803)	(956,889)	(1,088,221)

E. Results

The overall decrease in federal and state income tax expense from 2016 to TY 2019 is primarily a function of the federal corporate income tax rate reduction under the TCJA, which is partially offset by increasing book income before taxes resulting from the return on a growing rate base (see the testimony of Patrick D. Moersen, Exhibit SCG-35-2R, for a discussion of rate base). Federal and state tax adjustments are also growing annually, which, in turn, partially offset the growth in book income before taxes from 2016 to TY 2019.

F. Tax Memorandum Account

1. Background

In SoCalGas' 2016 GRC Decision,[61] the Commission instructed SoCalGas to establish a TMA for the 2016 GRC cycle (January 1, 2016 – December 31, 2018).[62] As stated by the Commission, the purpose of the TMA "is to increase the transparency of the utilities' incurred and forecasted income tax expenses to the Commission, so that the Commission can more closely examine the revenue impacts caused by the utilities' implementation of various tax laws, tax policies, tax accounting changes, or tax procedure changes."[63] The TMA "shall remain open and the balance in the account shall be reviewed in every subsequent GRC proceeding until a Commission decision closes the account."[64]

Pursuant to the Commission's directives, SoCalGas filed Advice Letter No. 4994-A on September 16, 2016 to establish the TMA. As further discussed in the testimony of SoCalGas witness Rae Marie Yu (Exhibit SCG-42), the TMA is a two-way tracking account that separately tracks the revenue requirement impact of the differences between tax expenses forecasted and tax expenses incurred resulting from: (1) net revenue changes resulting from differences between forecasted federal and state tax adjustments and tax credits to incurred federal and state tax adjustments and tax credits; (2) mandatory tax law changes, tax accounting changes, tax procedural changes, and tax policy changes; (3) elective tax law changes, tax accounting changes, tax procedural changes, and tax policy changes; (4) the completion of audits by federal and state taxing authorities; and (5) the implementation of any IRS private letter ruling regarding compliance with IRS normalization regulations.

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[61] D.16-06-054.
[62] *Id.* at Ordering Paragraph 4.
[63] *Id.* at 196.
[64] *Id.*

The Commission approved Advice Letter No. 4994-A on December 5, 2016. Consistent with D.16-06-054, SoCalGas is tracking and will continue to track the items in the TMA in accordance with the provisions of Advice Letter No. 4994-A until such time that the Commission closes the account.

2. Clarification of the Scope and Intent of the TMA from PG&E's 2017 GRC Decision

In its final decision in Pacific Gas and Electric Company's (PG&E's) 2017 GRC, the CPUC instructed PG&E to establish a TMA "consistent with our identical orders in the SDG&E and SoCalGas Test Year 2016 proceeding."[65] The stated purpose, terms, and requirements of PG&E's TMA were identical to what the CPUC had ordered in SoCalGas' 2016 GRC Decision.[66]

In comments to its proposed decision, PG&E raised several policy and practical concerns regarding the TMA, including the concern that, to the extent the TMA requires PG&E to true-up forecasted tax expenses for ratemaking purposes to the actual tax expenses incurred, the TMA is inconsistent with the CPUC's longstanding policy as stated in OII 24. The CPUC's policy as set forth in OII 24 is discussed below.

a. CPUC's Policy on True Up of Income Taxes

The CPUC held in OII 24 that the impact of tax adjustments in excess of or below what was forecasted in the GRC generally should not be trued up.[67] In its decision, the CPUC explained the view expressed by both CPUC staff and Industry representatives that seeking a change from this general ratemaking policy for a particular, isolated tax item would not be appropriate:

> Staff and Industry agree . . . that differences in income taxes between estimated and actual cannot be isolated from other factors in determining whether an adjustment should be made to the test-year estimate. Any review of differences would have to include the effects of differences of all estimates for revenues, operating expenses, income taxes and return on investment. Any prospective adjustment based on past over- or underestimates would have to take into consideration the overall effect of the differences for all components of the test-year. Under these

[65] D.17-05-013 at 116.
[66] *Id.* at 116-117.
[67] *See* 1984 Cal. PUC LEXIS 1325 at *33-34 ("such differences are inherent in the use of future test periods for ratemaking . . . Since income taxes are derived residually, we agree that individual factors should not be isolated for purposes of comparing estimated and recorded results.").

> circumstances parties recommend no change in the present ratemaking procedure.[68]

The CPUC in OII 24 agreed with the recommendation of the parties that it generally was not appropriate and not good policy to true up forecasted income taxes to actual amounts:

> Since income taxes are derived residually, we agree that individual factors should not be isolated for purposes of comparing estimated and recorded results. Obviously, if the utility earnings are substantially less than authorized, then a comparison of estimated and actual income taxes is misleading. Moreover, an across-the-board comparison of estimated and recorded results is not useful for any purpose other than informational, because it is consistent with test-year ratemaking.[69]

b. CPUC's Response to PG&E's Comments

The CPUC addressed PG&E's comments and clarified that the intent of the TMA is not to adopt a true-up mechanism for taxes, and that the CPUC has not changed its longstanding policy on this issue:

> PG&E's arguments rely on an incomplete reading of D.84-05-036 to oppose an outcome that is not, in fact, part of the APD. The Commission begins D.84-05-036 with an explanation that "[i]n the order that instituted this investigation we stated "the determination of reasonable allowable ratemaking expenses for federal and state income taxes is a matter of continuing concern to this Commission in its effort to establish reasonable utility rates." The Commission then addresses a number of specific questions with respect to taxes and appropriate ratemaking policies. PG&E cites D.84-05-036 and asserts that "[t]he Commission acknowledged that differences between estimated and recorded tax deductions and correspondingly estimated and recorded tax expense will occur in the ratemaking process and concluded that a true-up mechanism for taxes is not good policy." While the Commission does decline to "require utilities to submit adjustments reflecting reductions in taxes", it qualifies this result by stating "[w]e agree that changes in tax laws may be taken into account in ratemaking". The APD does not adopt any sort of "true-up mechanism"—rather, it adopts a mechanism that will provide the Commission with the information that it needs so that "changes in tax laws may be taken into account in ratemaking." PG&E appears concerned that the APD adopts what PG&E terms an "actual taxes" standard, stating "[i]n light of the widely recognized problems inherent in an actual taxes standard, it would be expected that a change in policy be preceded by a well-articulated explanation; however, the APD makes no reference to OII

[68] *Id.* at *33.
[69] *Id.* at *34.

> 24, let alone an attempt to rationalize the APD's outcome against the instruction in OII 24." Again, the APD makes no such change in policy.[70]

Accordingly, the CPUC clearly articulated in its decision in the PG&E 2017 GRC that the purpose and intent of the TMA is <u>not</u> to true up forecasted taxes to actual taxes, but rather to gain a better understanding of and visibility into "the revenue impacts caused by the utilities' implementation of various tax laws, tax policies, tax accounting changes, or tax procedure changes."[71]

3. 2016 TMA Balances

Based on the foregoing and in accordance with D.16-06-054, SoCalGas presents the 2016 TMA balance. A schedule that shows the TMA balances for 2016 (TMA Schedule) is attached as Appendix B. In order to provide additional transparency to the CPUC, and consistent with the CPUC's clarifications regarding the purpose and scope of the TMA as articulated in PG&E's 2017 GRC decision, the TMA Schedule separates the amount for each line item between: (a) the impact of differences between forecasted and incurred amounts related to changes in tax law, tax accounting, tax procedure, or tax policy, holding all other forecast items constant; and (b) the impact of differences <u>not</u> related to changes in tax law, tax accounting, tax procedure, or tax policy (*i.e.*, differences caused by differences in revenue, capital expenditures, the timing of when an asset is placed in service, etc.), holding all other forecast items constant. If the change in tax expense would decrease revenue, the amount is shown as a credit. If the change in tax expense would increase revenue, the amount is shown as a debit. Each line item in the TMA Schedule is discussed in turn, below.

a. Net Revenue Changes

The definition and scope of the "Net Revenue Changes" tracking item ordered by the Commission is unclear to SoCalGas. SoCalGas has interpreted "Net Revenue Changes" to mean the revenue impact of differences between incurred and authorized 2016 amounts for all income tax adjustments and credits.[72] As shown in the TMA Schedule, none of these differences for

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[70] D.17-05-013 at 226-227 (citations omitted).
[71] D.16-06-054 at 196; *see also* D.17-05-013 at 116-117.
[72] During a telephone call on August 1, 2017, the Commission's Energy Division provided clarifying guidance to SoCalGas that the Energy Division would also like to see the differences between incurred and authorized net operating loss carryforwards as a separately stated item in the TMA. Pursuant to the Energy Division's guidance, the TMA Schedule also includes the net operating loss carryforward amounts for 2016.

2016 were caused by changes in tax law, tax accounting, tax procedure, or tax policy. Rather, the differences between the incurred and authorized amounts were derived from residual factors outside of tax and thus represent the type of tax "true-up" discussed and rejected in OII 24.

b. Completion of Audits

There was no revenue impact for 2016 from completed federal or state audits.

c. IRS Rulings on Normalization Issues

There was no revenue impact from IRS Private Letter Rulings on normalization issues in 2016.

d. Mandatory Changes in Tax Law, Tax Accounting, Tax Procedures, or Tax Policy

There was no revenue impact from mandatory changes in tax law, tax accounting, tax procedures, or tax policy in 2016.

e. Elective Changes in Tax Law, Tax Accounting, Tax Procedures, or Tax Policy

There was no revenue impact from elective changes in tax law, tax procedures or tax policy in 2016.[73]

SoCalGas has not made any tax accounting method changes for 2016 as of the date of this Application; however, during 2016, SoCalGas adopted Accounting Standard Update (ASU) 2016-09 – Improvements to Employee Share-based Payment Accounting, issued by Financial Accounting Standards Board (FASB) in March 2016. The FASB issued this ASU to simplify several aspects of the accounting for employee share-based payment transactions. Under ASU 2016-09, excess tax benefits and tax deficiencies, which represent the difference between the tax return deduction amounts and the compensation cost recognized for financial reporting purposes, are required to be recognized as income tax expense or benefit in the income statement instead of in additional paid-in-capital (APIC) on the balance sheet. This book accounting change does not impact or change the deduction or loss companies take on their tax returns relating to the share-based payments.

ASU 2016-09 does not require any filing with or permission from the IRS or other taxing authority to implement; rather, it is purely a book accounting change under Generally Accepted

[73] The impact of the bonus depreciation extension under the PATH Act was incorporated in SoCalGas' 2016 GRC Decision; therefore, there is no 2016 impact to track for the PATH Act legislation since SoCalGas' 2016 GRC Decision reflects the 2016 50% bonus depreciation rate for the GRC period (*i.e.*, through 2018).

Accounting Principles (GAAP). Therefore, the adoption of ASU 2016-09 is likely outside the definition of the items that the CPUC ordered SoCalGas to track in its TMA. SoCalGas believes, however, that tracking the revenue impact of this book accounting change is consistent with the CPUC's desire to increase transparency and visibility of accounting elections that potentially impact revenues.

The book expense relating to the share-based payments, also called the Long Term Incentive Plan (LTIP), has not been included in SoCalGas' prior GRC revenue requirements approved by the CPUC, and thus the entire costs of the LTIP has been borne by the shareholders. Accordingly, the full amount of tax benefit recognized as tax expense on the income statement in 2016 from SoCalGas' adoption of ASU 2016-09 was funded by shareholders, and there is no revenue impact to SoCalGas ratepayers.[74]

4. Proposal for 2019 GRC Cycle

During SoCalGas' 2019 GRC cycle, SoCalGas will continue to notify the Commission of any tax-related law changes, accounting changes, policy changes, or procedural changes that materially affect (or may materially affect) revenues,[75] and will continue to report the revenue impact of any such changes to the Commission. SoCalGas believes that continuing to notify the Commission of such changes and the corresponding revenue impact during the 2019 GRC cycle is consistent with the CPUC's policy goals of gaining better visibility into the utilities' elections of various tax options, as stated by the Commission in SoCalGas' 2016 GRC Decision and as reiterated and clarified in PG&E's 2017 GRC Decision. Accordingly, SoCalGas believes a TMA is no longer necessary and requests that the Commission eliminate the TMA for SoCalGas' 2019 GRC cycle.

If the Commission disagrees with SoCalGas and believes that a TMA is necessary for the 2019 GRC cycle, SoCalGas proposes that the Commission reaffirm that the TMA is not intended to be a true-up mechanism for taxes (and thus is not intended to track the differences between forecasted and actual tax deductions that are caused by factors outside of tax and are unrelated to changes in tax law, tax accounting methods, tax procedures, or tax policy), but is intended to track the revenue impact of changes in tax law, tax accounting methods, tax procedures, and tax

[74] As discussed earlier, SoCalGas follows the CPUC's policy of excluding expenses not borne by customers in the calculation of income tax expense, as articulated by the CPUC in OII 24.
[75] Consistent with SoCalGas' 2016 GRC Decision, "materially affect" for this purpose means a potential increase or decrease of $3 million or more.

policy. Such a reaffirmation would be consistent with the Commission's long-standing policy of not truing-up differences between forecasted and actual tax deductions, as articulated by the Commission in OII 24 and in D.17-05-013. Accordingly, the differences, positive or negative, between forecasted and actual tax expenses caused by derivative factors outside of tax and unrelated to changes in tax law, tax accounting methods, tax procedures, or tax policy would continue to flow to SoCalGas' bottom line for each taxable year, consistent with the Commission's long-standing policy.[76] If the Commission is considering changing its long-standing policy on taxes and adopting an actual taxes standard, SoCalGas believes that the Commission should first initiate an Order Instituting Rulemaking (OIR) or other regulatory proceeding with all the utilities under the Commission's jurisdiction to evaluate the potential impact of such a policy change.

V. FRANCHISE FEES

A. Introduction

The purpose of this section is to provide background and analysis for SoCalGas' franchise fees as estimated for TY 2019.

B. Discussion

Franchise fees are payments made to counties and incorporated cities pursuant to local ordinances granting a franchise to the company to place utility property in the public rights of way. These facilities include pipes and appurtenances for transmitting and distributing gas. As of January 1, 2017, SoCalGas had franchise fee agreements with 248 taxing jurisdictions.

The franchise fee requirements are based upon gross receipts representing the recovery of base margin. The franchise factor upon which the estimated 2017-2019 franchise fees were determined is based on a summary of 2016 gas sales, transportation revenues, rate refunds, state fees, uncollectibles, and miscellaneous service receipts. The factor was adjusted to forecasted 2019 levels based on historic trends in franchise payment data and by factoring in expectations of future franchise fee rates.

Franchise fees are calculated using two formulas: (1) the "Broughton Act" formula, and (2) the "Percent of Gross Receipts" formula. The Broughton Act formula, as prescribed by CPUC guidelines, is calculated based upon the summarized receipts within each city or county as allocated by gas pipeline mileage in their public rights-of-way, and the applicable franchise fee

[76] *See* 1984 Cal. PUC LEXIS 1325 at *33-34.

rate pursuant to the franchise fee ordinance. The Percent of Gross Receipts formula is calculated based upon the summarized receipts within each city or county and the applicable franchise fee rate pursuant to the franchise fee ordinance.

The franchise agreement with each taxing authority specifies which of the above methods SoCalGas will use to determine its franchise fee liability. The majority of agreements require that the franchise fee be calculated under both methods with SoCalGas paying the higher of the two calculated fees. The remaining agreements specify that only the Broughton Act or Percent of Gross Receipts method be used.

The total payments to all taxing authorities were summed and divided by total receipts to arrive at a system-wide franchise fee factor. The system-wide franchise fee factors for the most recent five years were then averaged to yield a forecasted average franchise fee factor for TY 2019. The average franchise fee factor for TY 2019 is projected to be 1.3720% based on the trend from actual 2012-2016 franchise fees.[77]

C. Summary of Estimated Franchise Fees

Table SCG-RGR-4-1 below provides the Franchise Fees as estimated for the 2019 TY.

Table SCG-RGR-4-1

($ in Thousands)

Line No.	*Title*	*2016 Recorded*	*2017 Forecast*	*2018 Forecast*	*2019 Test Year*
1	Franchise Fees	26,698	31,392	33,201	39,091

D. Results

As noted above, the change in franchise fee expense from 2016 to 2019 results from changes in base margin as presented by other witnesses in their direct testimonies.

VI. CONCLUSION

This concludes my prepared direct testimony.

[77] The forecast methodology used to estimate the franchise fee factor does not reflect ongoing or upcoming negotiations with local jurisdictions, the results of which may be implemented during this GRC cycle.

VII. WITNESS QUALIFICATIONS

My name is Ragan G. Reeves. I am employed by Sempra Energy, SoCalGas' parent company, as a Principal Tax Counsel. My business address is 488 8th Avenue, HQ08N1, San Diego, California 92101-7123. I advise SoCalGas and Sempra Energy's other business units on the implications of federal and state tax law, including tax compliance issues, tax audit issues and strategies, and proposed acquisitions and restructurings.

Prior to joining Sempra Energy in 2005, I worked as a tax attorney for eight years at Miller & Chevalier, Chartered, in Washington, D.C., where my practice focused on tax credits, tax litigation, and tax controversy matters.

I received a Bachelor's of Business Administration in Accounting, a Masters in Professional Accounting, and a Juris Doctorate from the University of Texas at Austin. I am licensed to practice law in the District of Columbia and Texas, and I am a registered in-house counsel in California. I am also a licensed Certified Public Accountant in Texas.

I have previously testified before the CPUC.

APPENDIX A – GLOSSARY OF TERMS

A.: Application
ACRS: Accelerated Cost Recovery System
ADFIT: accumulated deferred federal income tax
ADR: Asset Depreciation Range
AFUDC: allowance for funds used during construction
APIC: Additional Paid-In-Capital
ARAM: Average Rate Assumption Method
ASU: Accounting Standard Update
CEA: capitalized earnings ability
CCFT: California Corporation Franchise Tax
CET: California Employment Training
CIAC: contribution in aid of construction
CPUC: California Public Utilities Commission
CWIP: Construction Work in Progress
D.: Decision
ERTA: Economic Recovery Tax Act of 1981
FASB: Financial Accounting Standards Board
FICA: Federal Insurance Contributions Act
FTB: Franchise Tax Board
FUTA: Federal Unemployment Tax Act
GAAP: Generally Accepted Accounting Principles
GRC: General Rate Case
HCLD: historical cost less depreciation
HI: Hospital Insurance (i.e., Medicare)
IRC: Internal Revenue Code
IRS: Internal Revenue Service
ITC: Investment Tax Credit
ITCC: Income Tax Component of CIAC
LTIP: Long Term Incentive Plan
LPPP: Long Production Period Property
MACRS: Modified Accelerated Cost Recovery System
O&M: Operations and Maintenance
OASDI: Old Age, Survivors, and Disability Insurance
OII: Order Instituting Investigation
OIR: Order Instituting Rulemaking
PATH Act: The Protecting Americans from Tax Hikes Act of 2015
PG&E: Pacific Gas and Electric Company
Pacific Lighting: Pacific Lighting Gas Supply Company
Regs: Treasury Regulations
SBE: California State Board of Equalization
SoCalGas: Southern California Gas Company
SUI: State Unemployment Insurance
TCJA: Tax Cuts and Jobs Act
TMA: Tax Memorandum Account
TRA 86: Tax Reform Act of 1986
TY: Test Year
UI: Unemployment Insurance

APPENDIX B

2016 TAX MEMORANDUM ACCOUNT TRACKING SCHEDULE

APPENDIX B

TAX MEMORANDUM ACCOUNT TRACKING SCHEDULE

SoCalGas						
Tax Memorandum Account Tracking Schedule						
For the Tax Year Ended December 31, 2016						
($ amounts in thousands)						
	Incurred Amount	**Amount Authorized in 2016 GRC**	**Difference**	**Difference NOT Related to Changes in Tax Law, Tax Accounting, Tax Procedure, or Tax Policy**	**Difference Related to Changes in Tax Law, Tax Accounting, Tax Procedure, or Tax Policy**	
1) Incurred vs Authorized Tax Adjustments and Credits						
Federal and State Tax Adjustments and Credits	(52,114)	(34,998)	(17,115)	(17,115)	0	[a]
Federal Tax Impact of California Franchise Tax	6,463	5,637	826	826	0	[b]
After-Tax Differences	(45,650)	(29,361)	(16,289)	(16,289)	0	[c] = [a] + [b]
Gross-Up Rate Applied to Differences				1.68746	1.68746	[d]
Subtotal				(27,487)	-	[e] = [c] * [d]
Impact of Corrollary Basis Adjustments				832	-	[f]
Impact of Net Operating Loss ("NOL") Carryforwards	5,254	4,220	1,034	1,034	-	[g]
Revenue Impact of Differences				(25,622)	0	[h] = [e] + [f] + [g]
2) Adjustments due to Completion of Audits						
None				0	0	[i]
3) Adjustments due to IRS Private Letter Rulings on Normalization Issues						
None				0	0	[j]
4) Mandatory Changes in Tax Law, Tax Accounting, Tax Procedures, or Tax Policy						
None				0	0	[k]
5) Elective Changes in Tax Law, Tax Accounting, Tax Procedures, or Tax Policy						
Adoption of ASU 2016-09 -- Accounting for Employee Stock-Based Compensation:						
Revenue Impact of Change				0	0	[l]
Total Revenue Impact of Differences/Changes				(25,622)	-	[m] = [h] + [i] + [j] + [k] + [l]
Interest (Payable)/Receivable				(54)	-	[n]
Ending Balance (Credit)/Debit				**(25,676)**	-	[o] = [m] + [n]

SCG 2019 GRC Testimony Revision Log – April 2018

Exhibit	Witness	Page	Line or Table	Revision Detail
SCG-37	Ragan G. Reeves	RGR-iii	2nd bullet point	Changed income tax expense from "$128.8 million" to "$48.2 million"; Changed ad valorem tax expense from "$78.1 million" to "$83.4 million"; and Changed franchise fees from "$39.9 million" to "$39.1 million"
SCG-37	Ragan G. Reeves	RGR-iii	4th bullet point	Added new bullet point: "The Tax Cuts and Jobs Act (TCJA) was enacted on December 22, 2017 (Pub. L. No. 115-97). The TCJA made comprehensive changes to federal tax law. The changes affecting SoCalGas include: (1) a reduction of the federal corporate tax rate from 35% to 21%, effective beginning in 2018; (2) the elimination of the bonus depreciation deduction for regulated utilities; (3) the elimination of the Internal Revenue Code (IRC) Section 199 deduction beginning in 2018; and (4) a requirement to return plant-related excess deferred taxes created by the reduction in the corporate tax rate to ratepayers ratably using the Adjusted Rate Assumption Method (ARAM) as described in the TCJA."
SCG-37	Ragan G. Reeves	RGR-1	Line 7	Added new footnote, which states: "The 2017 results of the TMA will not be known until the incurred amounts are final, which will occur when SoCalGas files its federal and California 2017 income tax returns. SoCalGas expects to file those tax returns in October 2018."
SCG-37	Ragan G. Reeves	RGR-1 to RGR-4	Line 17 to Line 12	Added new Section I.C – Impact of the Tax Cuts and Jobs Act
SCG-37	Ragan G. Reeves	RGR-5	Lines 10-13	Modified as follows: "The ~~2016~~ Federal Unemployment Tax Act (FUTA) tax rate was 2.4% <u>for 2016 and 2.7% for 2017</u> on wages up to $7,000. Based on currently enacted law, the FUTA tax rate is expected to ~~increase to 2.7% for 2017, and then is expected to~~ decrease to 0.6% for 2018 and 2019. The FUTA wage base is not expected to change through 2019."

Exhibit	Witness	Page	Line or Table	Revision Detail
SCG-37	Ragan G. Reeves	RGR-5	Lines 18-19	Modified as follows: "<u>The UI rate decreased to 3% for 2017.</u> Based on currently enacted law, the UI tax rate is expected to ~~decrease to~~ <u>remain at</u> 3.0% for 201~~7~~<u>8 and</u> 2019.
SCG-37	Ragan G. Reeves	RGR-5	Footnote 10	Modified as follows: "*See* Table V.C1, 2017 Annual Report. <u>If the projected OASDI wage bases change in the 2018 Annual Report when that report is issued, and if such changes would cause a material change to forecasted payroll taxes for 2019, SoCalGas will update its 2019 payroll tax forecast in its Update Testimony filing (consistent with SoCalGas' approach in prior GRCs).</u>"
SCG-37	Ragan G. Reeves	RGR-9	Table SCG-RGR-2-2	Revised table
SCG-37	Ragan G. Reeves	RGR-10	Line 5	Modified as follows: "This section also presents the 2016 results of the TMA ~~as of the date of this Application~~." Delete former footnote 13, which read: "The incurred amounts for 2016 are subject to change until the 2016 federal and California income tax returns are filed. Those tax returns have not been filed as of the date of this Application. In addition, the incurred amounts for 2016 do not yet reflect any adjustments from the completion of audits, because any audit adjustments for the 2016 tax year will not be known until future years."
SCG-37	Ragan G. Reeves	RGR-11	Lines 3-8	Modified as follows: "<u>For 2016 and 2017,</u> SoCalGas has utilized ~~current~~ <u>the</u> federal and state statutory tax rates of 35% and 8.84%, respectively, in developing its estimate of federal and state income tax expense <u>for those years. Pursuant to the change in the federal corporate tax rate beginning in 2018 under the TCJA, SoCalGas has utilized the current federal and state statutory tax rate of 21% and 8.84%, respectively, in developing its estimate of federal and state income tax expense for 2018 and 2019.</u>"
SCG-37	Ragan G. Reeves	RGR-11	Lines 23- 24	Modified as follows: "Consistent with CPUC policy, where normalization is not required by the IRC, SoCalGas <u>generally</u> has flow through tax deductions."

Exhibit	Witness	Page	Line or Table	Revision Detail
SCG-37	Ragan G. Reeves	RGR-12	Lines 14-22; Footnote 26	Modified as follows: "SoCalGas' federal income tax expense has been reduced by the amortization of remaining excess deferred federal income taxes resulting from a reduction in the federal income tax rate from a high of 41% prior to the Tax Reform Act of 1986 (TRA 86) to the current 21% under the TCJA beginning in 2018 ~~to the current 35% beginning in 1993~~, utilizing the Average Rate Assumption Method (ARAM) as required by Internal Revenue Service (IRS) normalization rules and mandated by D.88-01-061. Additionally, ARAM is the required method for amortizing plant-related excess AFDIT resulting from the tax rate reduction under the TCJA. Only a small amount of excess AFDIT remains from the decrease in tax rate under TRA 86. The ARAM amount increases significantly beginning in 2018, due to the reduction in the federal corporate income tax rate from 35% to 21% under the TCJA. The ARAM rules and methodology required under the TCJA are discussed in more detail in Section IV.C.3 below. Added new footnote 26: "TCJA Section 13001(d)(3)(B)."
SCG-37	Ragan G. Reeves	RGR-12	Line 23	Modified as follows: "~~The Tax Reform Act of 1986 (~~TRA 86~~)~~…"
SCG-37	Ragan G. Reeves	RGR-13	Lines 3-4	Modified as follows: "As prescribed by the CPUC in D.84-05-036, SoCalGas used the statutory federal tax rate of 35% for 2016-2017 and 21% for 2018-2019, …."
SCG-37	Ragan G. Reeves	RGR-14 to RGR-15	Line 25 to Line 6	Modified as follows: "SoCalGas follows the guidance in IRS Revenue Ruling 2000-7, which provides a current tax deduction for actual costs to remove assets retired from service in the year that those costs are incurred. For book purposes, estimates of such costs are capitalized and depreciated over the life of the assets. Thus, there is a timing difference between tax and book. To be consistent with the treatment of property that is being depreciated under the Accelerated Cost Recovery System (ACRS) or the Modified Accelerated Cost Recovery System (MACRS) as described above, SoCalGas normalizes the costs to remove those assets for federal tax purposes and flows through the ~~However, under the normalization rules, costs to remove assets that have been depreciated using the~~

Exhibit	Witness	Page	Line or Table	Revision Detail
				~~Accelerated Cost Recovery System (ACRS) or Modified Accelerated Cost Recovery System (MACRS) cannot be flowed through. Accordingly,~~ federal removal costs ~~are deducted~~ only on pre-1981 vintage assets retired from service. This treatment is consistent with ~~D.93848~~<u>prior GRCs</u>."
SCG-37	Ragan G. Reeves	RGR-15	Line 10	Added sentence: "This treatment is consistent with prior GRCs."
SCG-37	Ragan G. Reeves	RGR-15	Lines 16-24; Footnote 34	Added the following paragraph: "Employee Transportation Benefits. Prior to the enactment of the TCJA, employers generally were allowed a deduction for the costs associated with providing transportation fringe benefits to its employees, such as parking and commuter rail costs, under IRC Section 274. The TCJA amended IRC Section 274 effective January 1, 2018 to eliminate the deduction for expenses incurred in providing any transportation to employees, or any payment or reimbursement for transportation fringe benefits to employees, except as necessary to ensure the safety of the employee. SoCalGas continues to provide transportation fringe benefits to its employees; however, since such costs are no longer deductible under the TCJA, SoCalGas must add back these costs in computing taxable income beginning in 2018." Added new footnote 33: "TCJA Section 13304(c)."
SCG-37	Ragan G. Reeves	RGR-16	Lines 5-6	Modified as follows: "see the testimony of Patrick D. Moersen, Exhibit SCG-35-<u>2R</u>, for a discussion of rate base."
SCG-37	Ragan G. Reeves	RGR-16	Line 13	Added new subheading: "a. Extension under the PATH Act"
SCG-37	Ragan G. Reeves	RGR-17	Line 19	Modified as follows: "…the extra bonus depreciation multiplied by the ~~35%~~ federal income…"
SCG-37	Ragan G. Reeves	RGR-17	Lines 22-23	Modified as follows: "…additional deferred taxes created by the PATH Act's extension of bonus depreciation ~~for 2015 through 2019~~ are reflected in the accumulated deferred tax balances for purposes of calculating rate base ~~for TY 2019~~…"

Exhibit	Witness	Page	Line or Table	Revision Detail
SCG-37	Ragan G. Reeves	RGR-18 to RGR-19	Line 3 to Line 23	Added new subsection IV.C.1.b – Changes to the Bonus Depreciation Rules under the TCJA
SCG-37	Ragan G. Reeves	RGR-20 to RGR-23	Line 19 to Line 3	Added new subsection IV.C.3 – Excess Deferred Taxes Related to the TCJA
SCG-37	Ragan G. Reeves	RGR-23	Table SCG-RGR-3-1	Revised table
SCG-37	Ragan G. Reeves	RGR-24	Table SCG-RGR-3-2	Revised table
SCG-37	Ragan G. Reeves	RGR-25	Lines 2-7	Modified as follows: "The ~~increase~~ overall decrease in federal and state income tax expense from 2016 to TY 2019 is primarily a function of the federal corporate income tax rate reduction under the TCJA, which is partially offset by increasing book income before taxes resulting from the return on a growing rate base (see the testimony of Patrick D. Moersen, Exhibit SCG-35-2R, for a discussion of rate base). Federal and state tax adjustments are also growing annually which, in turn, partially offsets~~ting~~ the growth in book income before taxes from 2016 to TY 2019."
SCG-37	Ragan G. Reeves	RGR-29	Footnote 74	Modified footnote to delete last sentence, which read: "SoCalGas does expect to have a revenue impact related to the PATH Act legislation in its 2018 TMA, when the actual bonus depreciation rate drops from 50% to 40%. SoCalGas will track any such revenue impact in its TMA for 2018."
SCG-37	Ragan G. Reeves	RGR-32	Table SCG-RGR-4-1	Revised table