

Company: San Diego Gas & Electric Company (U 902 M)
Proceeding: 2019 General Rate Case
Application: A.17-10-007
Exhibit: SDG&E-35-2R

SECOND REVISED

SDG&E

DIRECT TESTIMONY OF RAGAN G. REEVES

(TAXES)

April 6, 2018

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**



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SUMMARY

- My testimony presents San Diego Gas & Electric Company's (SDG&E) estimated tax expense for Test Year (TY) 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 \$80.8 million, payroll tax expense of \$18.4 million, ad valorem tax expense of \$106.2 million, and franchise fees of \$69.3 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 SDG&E 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.

1 **SECOND REVISED SDG&E DIRECT TESTIMONY OF RAGAN G. REEVES**
2 **(TAXES)**

3 **I. INTRODUCTION**

4 **A. Summary of Proposals**

5 My testimony presents San Diego Gas & Electric Company's (SDG&E's) estimated tax
6 expense for Test Year (TY) 2019, and explains how those estimates were derived. My testimony
7 also presents the 2016 results of the Tax Memorandum Account (TMA).¹

8 **B. Organization of Testimony**

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

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

17 **C. Impact of the Tax Cuts and Jobs Act**

18 Pursuant to the Assigned Commissioner's Scoping Memorandum and Ruling issued on
19 January 29, 2018 (Scoping Memo), this exhibit has been revised to reflect the impact of the Tax
20 Cuts and Jobs Act (TCJA) on the SDG&E TY 2019 General Rate Case (GRC). The TCJA was
21 enacted on December 22, 2017.³ The TCJA was the most comprehensive tax reform legislation
22 to be enacted into law in more than thirty years. The changes to federal tax law under the TCJA
23 affected both individuals and corporations. The TCJA also included provisions specific to
24 regulated utilities such as SDG&E. Most of the changes to federal tax law under the TCJA
25 became effective beginning on January 1, 2018, although certain changes related to bonus
26 depreciation became effective on September 28, 2017. The most significant change under the
27 TCJA for corporations generally, and for regulated utility corporations specifically, was the

¹ The 2017 results of the TMA will not be known until the incurred amounts are final, which will occur when SDG&E files its federal and California 2017 income tax returns. SDG&E 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).

1 lowering of the federal corporate tax rate from 35% to 21% beginning in 2018. The lower
2 corporate rate results in a significant decrease in SDG&E’s tax expense.

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

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

17 Sempra’s consolidated TY 2019 GRC is currently in progress (A.17-10-
18 007/A.17-10-008). Rates for attrition year 2018 were adopted in D.16-06-
19 054, which also directed SoCalGas and SDG&E to each establish a Tax
20 Memorandum Account to capture the revenue requirement impact of
21 future tax law changes, such as the TCJA.

22
23 ***TCJA Implementation:*** Since Sempra’s TY 2019 GRC is currently open,
24 Sempra should follow the rulings of the presiding officer in that
25 proceeding and submit additional TCJA testimony and a revised TY 2019
26 Results of Operations (RO) model incorporating impact of the TCJA as
27 directed. This will allow the Commission to determine the most effective
28 way to return the TCJA benefits to customers.

29
30 Sempra should also follow instructions of the presiding officer regarding
31 the need for any filings in that same GRC regarding the TCJA-related
32 balance in the Tax Memorandum Account accumulated through 2018.

33
34 Consistent with the instructions in the Scoping Memo and the ED Letter, SDG&E is
35 providing this revised Tax testimony to discuss and reflect the impact of the TCJA for SDG&E’s

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.

1 2019 TY. SDG&E also made the following updates to the 2019 Results of Operations Model
2 (RO Model) to reflect the impact of the TCJA on SDG&E's 2019 TY:⁵

- 3 • Changed the federal corporate tax rate from 35% to 21% for the 2018 and 2019
4 tax years. This change is discussed in more detail in Section IV.B.1 below.⁶
- 5 • Re-measured the accumulated federal deferred income tax (AFDIT) balance as of
6 January 1, 2018 to reflect the new federal corporate tax rate of 21%. The excess
7 deferred taxes, which represents the difference between the AFDIT balance at the
8 prior 35% rate and the AFDIT balance at the new 21% rate, will be refunded to
9 ratepayers in the manner prescribed by the TCJA. The reduction to AFDIT
10 related to the TCJA is offset in the RO Model by a corresponding regulatory
11 liability that reduces rate base, so there is no net impact to rate base from the re-
12 measurement of deferred taxes on January 1, 2018. This change is discussed in
13 more detail in Section IV.C.3 below.
- 14 • Increased the ARAM adjustment for 2018 and 2019 to reflect the TCJA's
15 requirement to return plant-related excess deferred taxes to ratepayers ratably
16 using the ARAM calculation as described in the TCJA. This change is discussed
17 in more detail in Section IV.C.3 below.
- 18 • Changed the calculation of bonus depreciation to reflect the elimination of the
19 bonus depreciation deduction for regulated utilities. This change is discussed in
20 more detail in Section IV.C.1 below.
- 21 • Eliminated the IRC Section 199 deduction beginning in 2018. This change is
22 discussed in more detail in Section IV.B.2 below.

⁵ While 2018 is an attrition year of SDG&E's 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, SDG&E updated the Energy Division's computation of the repairs deduction rate base adjustment, set forth in SDG&E's 2016 GRC Decision (D.16-06-054 at Appendix B), by changing the federal corporate tax rate for 2018 through 2042. The repairs deduction rate base adjustment was calculated based on "future tax expense" to ratepayers for the 2016 – 2042 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 – 2042 tax years. The details of SDG&E's 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.

1 In addition, as directed in the ED Letter, SDG&E will track the impact of the TCJA
2 through 2018 in its TMA⁷ and will follow the instructions of the presiding officer in this
3 proceeding regarding the need for any filings in this GRC regarding the prior rate cycle. In the
4 meantime, as discussed in the Supplemental Testimony of Norma Jasso (Exhibit SDG&E-41-S),
5 SDG&E is requesting a sub-account in the TMA to specifically track the impacts of the TCJA
6 and to provide a discrete disposition for the balance that is being tracked in the TMA related to
7 the TCJA through 2018. SDG&E will provide a forecast of impacts of the TCJA through 2018
8 and proposes to provide such forecast in its Update Testimony filing in this proceeding if the
9 sub-account has been established by that time.⁸ SDG&E looks forward to working with the
10 Commission, Administrative Law Judge Lirag, and parties to determine the best method for
11 returning to its customers the benefits of the reduced tax expense through 2018 related to the
12 TCJA.

13 **II. PAYROLL TAXES**

14 **A. Introduction**

15 The purpose of this section is to provide an estimate of SDG&E's 2019 payroll tax
16 expenses, and to describe the methodology used to develop SDG&E's estimate.

17 **B. Discussion**

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

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 SDG&E files its federal and California 2018 income tax returns. SDG&E expects to file those tax returns in October 2019.

⁸ As of the date of this Second Revised Testimony, SDG&E has not finalized its forecast of the TCJA's impacts through 2018. This is primarily due to SDG&E's 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 SDG&E's 2016 GRC, which creates some unique challenges in updating the 2016 RO Model to reflect the impact of the TCJA for 2018. SDG&E continues to diligently work through and resolve those challenges related to the 2016 RO Model.

1 **1. Federal Insurance Contributions Act**

2 Federal Insurance Contributions Act (FICA) taxes, also referred to as social security
3 taxes, are composed of two pieces: (1) the Old-Age, Survivors, and Disability Insurance
4 (OASDI), and (2) the Hospital Insurance (HI or Medicare). For 2016, the OASDI tax rate was
5 6.2% of wages up to a maximum wage base of \$118,500. The Medicare tax rate was 1.45% of
6 wages with no maximum wage base. Based on rate schedules contained in the 2017 Annual
7 Report published by the Social Security Administration (2017 Annual Report), the employer’s
8 portion of the OASDI and Medicare tax rates have been at current levels since 1990 and are not
9 expected to change through 2019 based on currently enacted law.⁹ The OASDI wage base is
10 \$127,200 for 2017 and is projected to increase to \$130,500 for 2018 and \$135,600 for 2019
11 based on data reported in the 2017 Annual Report.¹⁰

12 **2. Federal Unemployment Tax Act**

13 The Federal Unemployment Tax Act (FUTA) tax rate was 2.4% for 2016 and 2.7% for
14 2017 on wages up to \$7,000. Based on currently enacted law, the FUTA tax rate is expected to
15 decrease to 0.6% for 2018 and 2019. The FUTA wage base is not expected to change through
16 2019.

17 **3. California State Unemployment Insurance**

18 The California State Unemployment Insurance (SUI) is composed of two pieces: (1) the
19 Unemployment Insurance (UI), and (2) the California Employment Training Tax (CET). The
20 2016 UI tax rate was 3.1% on wages up to \$7,000. The CET tax rate was an additional 0.1% on
21 wages up to \$7,000. The UI rate decreased to 3% for 2017. Based on currently enacted law, the
22 UI tax rate is expected to remain at 3.0% for 2018 and 2019. The CET tax rate and wage bases
23 for SDG&E are not expected to change through 2019.

24 **4. Methodology Used to Estimate Tax Expense**

25 Payroll taxes are a function of taxable wages and applicable tax rates. The computation
26 of the estimated payroll taxes begins with the 2016 taxable wages stratified into salary

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, SDG&E will update its 2019 payroll tax forecast in its Update Testimony filing (consistent with SDG&E’s approach in prior GRCs).

1 increments. The annual wage base in effect for the year for each type of payroll tax was applied
 2 to total wages to ensure that wages up to, but not exceeding, the wage base cap were subject to
 3 the tax. Thus, wages up to the salary increment where the annual wage is closest to the wage
 4 base cap are subject to the tax. Wages above the wage base cap for any particular type of payroll
 5 tax were derived from multiplying the number of employees in each stratum above the cap by the
 6 wage base cap. The resulting taxable wages for each tax type were totaled and the applicable
 7 statutory tax rate was then applied to the total taxable wages. The Medicare portion of the FICA
 8 tax is computed without respect to a wage base since all wages are subject to that tax. A
 9 companywide composite tax rate was computed based on total forecasted payroll taxes using the
 10 above methodology divided by total forecasted wages. The composite payroll tax rate for each
 11 year was applied to labor dollars applicable to this filing to determine the employer's payroll tax
 12 expense.

13 **C. Summary of Estimated Payroll Taxes**

14 Table SDG&E-RGR-1 below summarizes the amount of payroll taxes on all non-
 15 capitalized wages applicable to this filing.

16 **Table SDG&E-RGR-1**
 17 **Summary of Estimated Payroll Taxes**
 18 **(\$ in Thousands)**

	<i>Line No.</i>	<i>2016 Recorded</i>	<i>2017 Estimated</i>	<i>2018 Estimated</i>	<i>2019 Test Year</i>
Electric Distribution	1	9,005	10,409	10,857	11,518
Gas Distribution	2	4,176	5,258	5,577	5,942
Electric Generation	3	0	958	963	978

19 **D. Results**

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

1 **III. AD VALOREM TAXES**

2 **A. Introduction**

3 The purpose of this section is to provide an estimate of SDG&E’s ad valorem taxes that
4 will be incurred during TY 2019, and to describe the methodology used to develop the estimate.

5 **B. Discussion**

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

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

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

1 SDG&E has filed its property statements with the SBE for the 2016 and 2017 lien dates.
2 The property statements form the basis of the appraisals to set the value of SDG&E's property
3 for the 2016-2017 and 2017-2018 fiscal years. The SBE reports the value of property subject to
4 ad valorem tax annually on the "Notice of Unitary Appraised Value," which SDG&E has
5 received for the 2016 and 2017 lien dates. In correlating the value indicators calculated by the
6 SBE from information contained in the property statement, the SBE applied a weighting of 75%
7 to the HCLD indicator and 25% to the CEA indicator to derive the total appraised value of
8 SDG&E's unitary property.¹¹ Added to the value of SDG&E's unitary property is the value of
9 SDG&E's non-unitary property.¹² In estimating ad valorem taxes for ratemaking purposes,
10 adjustments were made to exclude taxes resulting from: (a) the assessment of non-utility
11 property since it is not included as an operating expense, and (b) Construction Work in Progress
12 (CWIP), which is capitalized rather than directly charged to ad valorem tax expense. Also
13 excluded is the value of electric transmission property, since such property is excluded from this
14 proceeding.

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

18 The tax rate used to estimate California ad valorem taxes is the basic statewide tax rate of
19 1% established under Proposition 13, plus an additional rate component of 0.4986%, which is a
20 composite rate derived from dividing taxes paid to local jurisdictions by the total assessed value
21 of property in all voter approved local assessment districts as allowed under Proposition 13. The
22 escalation in the rates from 2016 to 2019 represents the average historical rate of increase in
23 local tax rates over the most recent five-year period.

24 The estimated ad valorem taxes for SDG&E's Desert Star Energy Center, which is
25 located in Nevada, are added to California ad valorem taxes as an "Other Adjustment" on the
26 Electric Generation summary table, Table SDG&E-RGR-2-3 below.

¹¹ Unitary property is property owned or used by the utility that the SBE has determined is used in the utility's 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 by the utility that the SBE has determined is not used in the utility's operating business.

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

The following tables, Table SDG&E-RGR-2-1, Table SDG&E-RGR-2-2, and Table SDG&E-RGR-2-3, summarize SDG&E’s estimated ad valorem tax expenses for Electric Distribution, Gas Distribution, and Electric Generation, respectively.

**Table SDG&E-RGR-2-1
San Diego Gas & Electric Company
Summary of Estimated Ad Valorem Tax Expenses
Electric Distribution
(\$ in Thousands)**

<i>Line No.</i>	<i>Description</i>	<i>2016 Recorded</i>	<i>2017 Estimated</i>	<i>2018 Estimated</i>	<i>2019 Test Year</i>
1	Taxable Plant in Service	7,396,329	7,819,195	8,451,524	9,231,340
2	Taxable Reserve for Depreciation	(2,769,061)	(2,934,016)	(3,105,897)	(3,279,736)
3	Taxable Net Plant	4,627,268	4,885,179	5,345,627	5,951,604
4	Taxable Reserve for Def. Inc. Tax	(573,978)	(597,349)	(629,766)	(363,958)
5	Adjustment for Income Approach	(148,350)	(156,935)	(172,601)	(204,508)
6	Assessed Value - Non-Unitary	13,277	14,045	15,447	18,303
7	Net Assessable Value	3,918,217	4,144,940	4,558,708	5,401,441
8	Ad Valorem Tax Rate	1.4986482%	1.5385850%	1.5785218%	1.6184586%
9	Ad Valorem Tax - Fiscal Year	58,720	63,773	71,960	87,420
10	Other Adjustments	34	34	34	34
	<u>Fiscal Year</u>				
11	Total Operating Ad Valorem Tax	58,754	63,807	71,994	87,454
12	Capitalized Ad Valorem Tax	(2,516)	(3,403)	(4,309)	(4,746)
13	Net Operating Ad Valorem Tax	56,238	60,404	67,685	82,709
	<u>Calendar Year (Note 1)</u>				
14	Total Operating Ad Valorem Tax	53,891	60,983	67,603	79,426
15	Capitalized Ad Valorem Tax	(4,064)	(2,608)	(3,603)	(4,420)
16	Net Operating Ad Valorem Tax	49,827	58,375	64,000	75,006

(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.

Table SDG&E-RGR-2-2
San Diego Gas & Electric Company
Summary of Estimated Ad Valorem Tax Expenses
Gas Distribution
(\$ in Thousands)

<i>Line No.</i>	<i>Description</i>	<i>2016 Recorded</i>	<i>2017 Estimated</i>	<i>2018 Estimated</i>	<i>2019 Test Year</i>
1	Taxable Plant in Service	1,927,644	2,033,578	2,257,267	2,450,178
2	Taxable Reserve for Depreciation	(978,555)	(1,016,097)	(1,053,910)	(1,092,449)
3	Taxable Net Plant	949,089	1,017,481	1,203,357	1,357,729
4	Taxable Reserve for Def. Inc. Tax	(105,175)	(119,410)	(137,364)	(82,835)
5	Adjustment for Income Approach	(30,887)	(32,869)	(39,015)	(46,661)
6	Assessed Value - Non-Unitary	2,764	2,942	3,492	4,176
7	Net Assessable Value	815,791	868,144	1,030,470	1,232,408
8	Ad Valorem Tax Rate	1.4986482%	1.5385850%	1.5785218%	1.6184586%
9	Ad Valorem Tax - Fiscal Year	12,226	13,357	16,266	19,946
10	Other Adjustments	6	6	6	6
<u>Fiscal Year</u>					
11	Total Operating Ad Valorem Tax	12,232	13,363	16,272	19,952
12	Capitalized Ad Valorem Tax	(728)	(880)	(1,430)	(1,914)
13	Net Operating Ad Valorem Tax	11,504	12,484	14,842	18,038
<u>Calendar Year (Note 1)</u>					
14	Total Operating Ad Valorem Tax	10,998	12,737	14,758	18,052
15	Capitalized Ad Valorem Tax	(809)	(742)	(897)	(1,843)
16	Net Operating Ad Valorem Tax	10,189	11,996	13,860	16,209

(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.

1

Table SDG&E-RGR-2-3
San Diego Gas & Electric Company
Summary of Estimated Ad Valorem Tax Expenses
Electric Generation
(\$ in Thousands)

<i>Line No.</i>	<i>Description</i>	<i>2016 Recorded</i>	<i>2017 Estimated</i>	<i>2018 Estimated</i>	<i>2019 Test Year</i>
1	Taxable Plant in Service	1,151,035	1,173,641	1,212,400	1,544,541
2	Taxable Reserve for Depreciation	(349,532)	(388,459)	(429,189)	(464,887)
3	Taxable Net Plant	801,503	785,182	783,211	1,079,654
4	Taxable Reserve for Def. Inc. Tax	(69,110)	(74,604)	(81,995)	(53,210)
5	Adjustment for Income Approach	(26,806)	(26,007)	(25,664)	(37,568)
6	Assessed Value - Non-Unitary	2,399	2,328	2,297	3,362
7	Net Assessable Value	707,987	686,898	677,848	992,238
8	Ad Valorem Tax Rate	1.4986482%	1.5385850%	1.5785218%	1.6184586%
9	Ad Valorem Tax - Fiscal Year	10,610	10,569	10,700	16,059
10	Other Adjustments	1,743	1,743	1,743	1,743
	<u>Fiscal Year</u>				
11	Total Operating Ad Valorem Tax	12,353	12,312	12,443	17,802
12	Capitalized Ad Valorem Tax	(220)	(194)	(164)	(175)
13	Net Operating Ad Valorem Tax	12,133	12,118	12,279	17,627
	<u>Calendar Year (Note 1)</u>				
14	Total Operating Ad Valorem Tax	11,285	12,270	12,315	15,060
15	Capitalized Ad Valorem Tax	(847)	(172)	(92)	(112)
16	Net Operating Ad Valorem Tax	10,438	12,099	12,224	14,948

2

3

4

(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.

1 **D. Results**

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

5 **IV. INCOME TAXES**

6 **A. Introduction**

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

10 **B. Discussion of Income Tax Expense**

11 **1. Methodology**

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

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

22 Another issue considered by the CPUC in OII 24 was whether expenses not borne by
23 customers should be included as income tax deductions in computing estimated TY income tax
24 expense. The CPUC stated that it had consistently calculated income taxes for ratemaking
25 purposes based on the cost of service developed from authorized expenses.¹⁴ The CPUC also
26 found that if they were to include expenses not subject to rate recovery as a deduction in
27 calculating taxable income, stockholders would be penalized by a reduction in their net income
28 equal to the full amount of the expenditures, because they would have no offsetting tax

¹³ 1984 Cal. PUC LEXIS 1325 at *57-58 (Finding of Fact 12); 15 CPUC 2d 42.

¹⁴ *Id.* at *15.

1 deduction.¹⁵ The Commission concluded that their method of excluding expenses not borne by
2 customers in the calculation of TY income tax expense is reasonable and should continue.¹⁶ As
3 such, SDG&E follows this conclusion of law from OII 24 in this GRC proceeding.

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

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

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

22 Where required, SDG&E has followed the normalization rules contained in Internal
23 Revenue Code Section (IRC) § 168, and Treasury Regulations Section (Treas. Reg.) § 1.167(l)-1
24 in computing federal income tax expense.¹⁹ Accordingly, federal tax depreciation on post-1980
25 vintage year assets has been “normalized” by using a book life and method to calculate tax
26 depreciation. Consistent with CPUC policy, where normalization is not required by the IRC,

¹⁵ *Id.* at *16-18.

¹⁶ *Id.* at *62 (Conclusion of Law 2).

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 financial accounting treatment for items of income and expense in the revenue requirement calculation.

1 SDG&E generally has employed flow-through accounting. For example, tax depreciation on
2 pre-1981 vintage assets has been flowed through as an adjustment to federal tax expense as
3 required by D.93848.²⁰

4 Tax expense based on income has been reduced by the amortization of deferred
5 Investment Tax Credits (ITC) generated in prior years in accordance with SDG&E's prior
6 election under applicable law²¹ to ratably flow through the ITC benefit as a reduction to
7 ratemaking tax expense at a rate not to exceed the book life of the property that generated the
8 ITC. This application conforms to the treatment of deferred ITC amortization mandated by
9 D.88-01-061²² and is the same treatment employed by SDG&E in prior rate cases.

10 SDG&E's federal income tax expense has been reduced by the amortization of remaining
11 excess deferred federal income taxes resulting from a reduction in the federal income tax rate
12 from a high of 41% prior to the Tax Reform Act of 1986 (TRA 86) to the current 21% under the
13 TCJA beginning in 2018, utilizing the Average Rate Assumption Method (ARAM) as required
14 by Internal Revenue Service (IRS) normalization rules and mandated by D.88-01-061.²³
15 Additionally, ARAM is the required method for amortizing plant-related excess AFDIT resulting
16 from the tax rate reduction under the TCJA.²⁴ Only a small amount of excess AFDIT remains
17 from the decrease in tax rate under TRA 86. The ARAM amount increases significantly
18 beginning in 2018, due to the reduction in the federal corporate income tax rate from 35% to
19 21% under the TCJA. The ARAM rules and methodology required under the TCJA are
20 discussed in more detail in Section IV.C.3 below.

21 TRA 86 adopted rules regarding capitalization of construction period interest for long-
22 lived assets that have an extended construction period. These rules were codified in IRC § 263A.
23 For book and ratemaking purposes, construction period interest is capitalized through an
24 allowance for funds used during construction (AFUDC). While similar in concept, there are
25 specific differences between the book and tax treatment of construction period interest. As in
26 prior rate cases, for tax purposes SDG&E follows the rules in IRC § 263A in this filing with
27 respect to the treatment of construction period interest.

²⁰ 1981 Cal. PUC LEXIS 1240; 7 CPUC 2d 332.

²¹ SDG&E's election under former IRC § 46(f)(2).

²² 1988 Cal. PUC LEXIS 102; 27 CPUC 2d 310.

²³ *Id.* at *95-96.

²⁴ TCJA Section 13001(d)(3)(B).

1 As prescribed by the CPUC in D.84-05-036, SDG&E used the statutory federal tax rate
2 of 35% for 2016-2017 and 21% for 2018-2019, and the statutory state tax rate of 8.84%, in its
3 development of the net-to-gross multiplier used to gross-up tax expense to a revenue
4 requirement.²⁵

5 **2. Schedule M Items and Other Specific Tax Deductions**

6 SDG&E makes several adjustments to book income in the form of Schedule M
7 adjustments to arrive at taxable income. In addition, there are other types of deductions
8 permitted under the IRC that have been incorporated into the computation of SDG&E's tax
9 expense, as discussed below.

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

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

18 Prior Year CCFT. Federal law allows a deduction for state income taxes paid. In
19 California, this is the CCFT deduction. For ratemaking purposes, D.89-11-058²⁶ specifies that
20 the allowable deduction is the prior years' CPUC-adopted CCFT, not the current year CCFT.
21 Since there is, as yet, no CPUC-adopted CCFT, SDG&E has used the prior year's CCFT
22 estimate in calculating federal tax expense for TY 2019.

23 Internally-Developed Software. For financial accounting purposes, software
24 expenditures are capitalized and amortized to expense over various lives. For tax purposes, a
25 current-year deduction is allowed under IRC § 174 for internally developed software
26 expenditures.²⁷ SDG&E has deducted internally developed software expenditures as a flow-

²⁵ 1984 Cal. PUC LEXIS 1325 at *62-63 (Conclusion of Law 9).

²⁶ 1989 Cal. PUC LEXIS 815 at *34 (Conclusion of Law 1); 33 CPUC 2d 495.

²⁷ 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.

1 through deduction pursuant to D.84-05-036.²⁸ IRC § 167(f)²⁹ requires capitalization of un-
2 modified, or “canned” software. SDG&E applies normalized tax accounting treatment to
3 expenditures for canned software pursuant to D.84-05-036.

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

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

18 Federal Cost of Removal. SDG&E follows the guidance in IRS Revenue Ruling 2000-
19 7,³⁰ which provides a current tax deduction for actual costs to remove assets retired from service
20 in the year that those costs are incurred. For book purposes, estimates of such costs are
21 capitalized and depreciated over the life of the assets. Thus, there is a timing difference between
22 tax and book. To be consistent with the treatment of property that is being depreciated under the
23 Accelerated Cost Recovery System (ACRS) or the Modified Accelerated Cost Recovery System
24 (MACRS) as described above, SDG&E normalizes the costs to remove those assets for federal
25 tax purposes and flows through the federal removal costs only on pre-1981 vintage assets retired
26 from service. This treatment is consistent with prior GRCs.

27 State Cost of Removal. California did not adopt the federal ACRS or MACRS
28 depreciation systems, choosing instead to remain on the ADR system. Accordingly, SDG&E

²⁸ 1984 Cal. PUC LEXIS 1325.

²⁹ IRC § 167(f) required capitalization of un-modified software purchased after August 10, 1993.

³⁰ 2000-1 C.B. 712.

1 flows through removal costs for CCFT purposes irrespective of the vintage of the underlying
2 assets per D.84-05-036.³¹ This treatment is consistent with prior GRCs.

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

8 Section 199 Deduction. The American Jobs Creation Act of 2004 added Section 199 to
9 the IRC. Under IRC § 199, manufacturers may deduct the lower of: (1) a fixed percentage of
10 their qualified production activities income, or (2) 50% of the wages of employees involved in
11 the qualified production activity. The fixed percentage is 9% of qualified income for tax years
12 after 2009. For public utilities, income derived from the generation of electricity qualifies for
13 deduction under Section 199. The TCJA eliminated the Section 199 deduction beginning with
14 the 2018 tax year.³² Accordingly, SDG&E has calculated a Section 199 deduction for its
15 qualified production of electricity in its calculation of income tax expense for 2016 and 2017
16 only. The deduction for those years is limited to the lesser of 9% of income from the production
17 of electricity or 50% of wages paid to employees engaged in the production of electricity. If the
18 company has no taxable income in a particular year, the Section 199 deduction is unavailable for
19 that year.

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

25 **C. Discussion of Deferred Taxes**

26 The accumulated deferred federal income tax (ADFIT) resulting from the difference
27 between normalized tax depreciation computed using a book life and book method and the
28 comparable tax depreciation computed using ACRS or MACRS has been included as an
29 adjustment to rate base in this GRC (see the testimony of R. Craig Gentes, Exhibit SDG&E-33-

³¹ 1984 Cal. PUC LEXIS 1325 at *59 (Finding of Fact 23).

³² TCJA Section 13305(a).

1 2R, for a discussion of rate base). SDG&E’s treatment of deferred taxes is in accordance with
2 IRC § 168(i)(9), Treas. Reg. § 1.167(l)-1, and numerous related IRS rulings that taken together
3 constitute the “tax normalization” requirements.

4 All current law has been followed in the development of deferred federal income taxes.
5 Accumulated deferred taxes for TY 2019 were developed on a monthly basis and prorated in
6 accordance with the normalization requirements in Treas. Reg. § 1.167(l)-1(h)(6)(ii).³³

7 **1. Bonus Depreciation**

8 **a. Extension under the PATH Act**

9 On December 18, 2015, President Obama signed into law The Protecting Americans from
10 Tax Hikes Act of 2015 (the PATH Act).³⁴ One of the provisions of the PATH Act was an
11 extension of the bonus depreciation rules, which has deferred tax implications for SDG&E’s TY
12 2019 forecasts.

13 The bonus depreciation rules allow taxpayers to immediately expense a specified
14 percentage of qualifying property placed into service in a particular year, rather than requiring
15 the taxpayer to depreciate the full amount of the property over multiple years. Unlike previous
16 extensions that generally extended bonus depreciation for only one year, the PATH Act extended
17 bonus depreciation to eligible property placed into service between January 1, 2015 and
18 December 31, 2019,³⁵ and for costs incurred before January 1, 2020 attributable to eligible long
19 production period property (LPPP)³⁶ that is placed into service before January 1, 2021.³⁷ The
20 bonus depreciation rules expire generally on December 31, 2019 (and expire on December 31,
21 2020 for eligible LPPP).

³³ 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.

³⁴ Pub. L. No. 114-113, H.R. 2029.

³⁵ IRC § 168(k).

³⁶ 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).

³⁷ IRC § 168(k)(2)(B).

1 The bonus depreciation percentage for eligible property placed in service in 2015-2017 is
2 50%.³⁸ The percentage decreases to 40% for 2018 and decreases further to 30% for 2019.³⁹
3 Special rules allow qualifying LPPP to receive a one-year extension on the bonus depreciation
4 phase-out rates. Therefore, for qualifying LPPP, the 50% bonus depreciation rate applies to
5 property placed in service in 2018, the 40% rate applies to property placed in service in 2019,
6 and the 30% rate applies to property placed in service in 2020.⁴⁰

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

11 For ratemaking purposes, bonus depreciation allowed by the PATH Act is subject to the
12 tax normalization rules contained in IRC § 168 and Treasury Regulations under former IRC §
13 167. The ratemaking effect of the PATH Act is to increase federal tax return depreciation for
14 2015 through 2019 above the regular tax depreciation provided by the federal MACRS
15 depreciation system. The extra bonus tax depreciation allowed by the PATH Act creates
16 additional deferred taxes equal to the extra bonus depreciation multiplied by the federal income
17 tax rate. The impact of the PATH Act's extension of bonus depreciation on SDG&E's 2015 and
18 2016 tax years was reflected in D.16-06-054 (SDG&E's 2016 GRC Decision);⁴¹ therefore, the
19 additional deferred taxes created by the PATH Act's extension of bonus depreciation are
20 reflected in the accumulated deferred tax balances for purposes of calculating rate base.

21 Except in the case of certain qualified self-constructed assets placed in service in 2005,
22 bonus depreciation has not been calculated on property placed in service between January 1,
23 2005 and December 31, 2007, when bonus depreciation was not allowed. The residual impact of
24 bonus depreciation taken on qualified property placed in service in prior periods is reflected in
25 the accumulated deferred income tax balances for 2016-2019.

26 **b. Changes to the Bonus Depreciation Rules under the TCJA**

27 The bonus depreciation rules under the TCJA supersede the bonus depreciation rules
28 under the PATH Act for qualified property acquired pursuant to a written binding contract and

³⁸ IRC § 168(k)(1)(A).

³⁹ IRC § 168(k)(6).

⁴⁰ *Id.*

⁴¹ *See* D.16-06-054 at 213.

1 placed in service after September 27, 2017.⁴² For such property, the TCJA generally increases
2 the bonus depreciation allowance to 100 percent through the end of 2022.⁴³ However, the TCJA
3 also specifies that bonus depreciation is not available for assets acquired in the trade or business
4 of the furnishing or sale of:

5 (I) electric energy, water, or sewage disposal services, (II) gas or steam
6 though a local distribution system, or (III) transportation of gas or steam
7 by pipeline, if the rates for such furnishing or sale, as the case may be,
8 have been established or approved by a State or political subdivision
9 thereof, by any agency or instrumentality of the United States, by a public
10 service or public utility commission or other similar body of any State or
11 political subdivision thereof, or by the governing or ratemaking body of an
12 electric cooperative.”⁴⁴

13
14 Accordingly, the TCJA eliminates the bonus depreciation deduction for regulated utilities, such
15 as SDG&E.

16 The TCJA includes a transition rule applicable to property acquired pursuant to a written
17 binding contract on or before September 27, 2017, but placed in service after such date. Under
18 the transition rule, the bonus depreciation rates and rules under the PATH Act still apply.⁴⁵
19 Thus, for property subject to the transition rule, qualified property placed in service in 2017 is
20 eligible for 50% bonus depreciation, property placed in service in 2018 is eligible for 40% bonus
21 depreciation, and property placed in service in 2019 is eligible for 30% bonus depreciation.⁴⁶

22 While it is clear that the TCJA eliminates the bonus depreciation deduction for regulated
23 utilities on a going forward basis, the precise manner in which the transition rule should be
24 applied remains unclear, in particular the application of the “acquisition” requirement. The IRS
25 and the United States Treasury Department (Treasury) recognized that additional guidance is
26 needed for the TCJA’s new bonus depreciation rules by adding “Guidance on new § 168(k)” as a
27 priority project in the most recent update to the IRS and Treasury’s 2017-2018 Priority Guidance
28 Plan (Guidance Plan).⁴⁷ The updated Guidance Plan “reflects 29 additional projects, including
29 those that have become near term priorities as a result of the Tax Cuts and Jobs Act

⁴² TCJA Section 13201(h)(1).

⁴³ TCJA Section 13201(a)(2).

⁴⁴ TCJA Sections 13201(d)(9)(A) and 13301(a).

⁴⁵ TCJA Section 13201(a)(3).

⁴⁶ *Id.*; I.R.C. § 168(k)(8)(A) and (B).

⁴⁷ Department of the Treasury 2017-2018 Priority Guidance Plan, 2nd quarter update (Feb. 7, 2018).

1 legislation.”⁴⁸ The Guidance Plan lists the priority guidance projects that the IRS and Treasury
2 “hope to complete during the twelve-month period from July 1, 2017 through June 30, 2018.”⁴⁹
3 Thus, it is possible that the IRS and Treasury will release additional guidance for the new bonus
4 depreciation rules under the TCJA by June 30, 2018, although there is no requirement for the
5 IRS and Treasury to meet this target date. Accordingly, it is uncertain if or when additional
6 guidance under the TCJA’s bonus depreciation rules will be released.

7 There is no consensus as yet among utilities or accounting firms on the application of the
8 transition rules. SDG&E has reviewed the statutory language of the new bonus depreciation
9 rules under the TCJA, discussed the issue with its outside advisors, and participated in industry
10 group discussions regarding the bonus depreciation rules. After its analysis and its discussions
11 with outside experts and its utility peers, SDG&E has concluded that the best interpretation of
12 the new rules is to follow the statutory language as written, and not to assume that any
13 forthcoming guidance from the IRS or Treasury will narrow, expand, or otherwise change the
14 application of the transition rules, or any other bonus depreciation rules under the TCJA. Such
15 assumption is consistent with SDG&E’s overall methodology on income taxes, which is to apply
16 the current tax law without attempting to predict potential future changes in tax law.
17 Accordingly, consistent with the language of the TCJA, SDG&E has not taken bonus
18 depreciation on any property that was placed in service after September 27, 2017 and was not
19 acquired pursuant to a written binding contract on or before such date.⁵⁰

20 **2. Contributions-in-Aid-of-Construction**

21 Contributions-in-aid-of-construction (CIAC) are non-refundable contributions collected
22 from utility customers in the form of money – or its equivalent – toward the construction of
23 plant, such as customer-requested relocations. CIAC became taxable under the TRA 86. The
24 CPUC proposed the Maryland Method or Method 5 as acceptable alternatives for the ratemaking
25 treatment of CIAC in D.87-09-026.⁵¹ SDG&E elected the Maryland Method to account for the

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ If the IRS or Treasury issue guidance clarifying the application of the bonus depreciation rules under the TCJA, and such guidance differs from SDG&E’s interpretation of the rules, SDG&E will revise its calculation of bonus depreciation to be consistent with such guidance. SDG&E 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.

⁵¹ 1987 Cal. PUC LEXIS 195; 25 CPUC 2d 299.

1 tax impacts of CIAC and the related income tax component of CIAC (ITCC) as required by the
2 TRA 86. Under the Maryland Method, the utility shareholders bear the impact of any shortfall
3 between the tax liability and the tax gross-up ITCC collected from the contributor. The
4 shareholders recover the shortfall through the tax depreciation benefits on the constructed
5 property. Accordingly, there is no impact on rate base under the Maryland Method. In
6 accordance with D.87-09-026, SDG&E has not reflected any impact on rate base for the tax paid
7 on CIAC income and the related ITCC received subsequent to February 10, 1987, the date that
8 CIAC became taxable under the TRA 86.

9 **3. Excess Deferred Taxes Related to the TCJA**

10 SDG&E has recomputed its AFDIT balances as of January 1, 2018 to reflect the
11 reduction in the federal corporate income tax rate from 35% to 21% under the TCJA. The
12 difference in the AFDIT balance under the old tax rate versus under the new tax rate represents
13 the excess deferred tax reserve created by the TCJA. The TCJA defines the “excess tax reserve”
14 as “(i) the reserve for deferred taxes (as described in section 168(i)(9)(A)(ii) of the Internal
15 Revenue Code of 1986) as of the day before the corporate rate reductions . . . made by this
16 section take effect, over (ii) the amount which would be the balance in such reserve if the amount
17 of such reserve were determined by assuming that the corporate rate reductions provided in this
18 Act were in effect for all prior periods.”⁵²

19 These excess deferred tax reserves belong to SDG&E’s customers, and SDG&E will
20 return the excess deferred taxes to its customers in full. But in doing so, SDG&E must adhere to
21 the timing rules and other requirements under the TCJA. Failure to follow these rules and
22 procedures will result in a normalization violation.⁵³ The TCJA specifies that utilities may not
23 return the excess AFDIT associated with utility plant assets (excess plant-based AFDIT) more
24 rapidly than ratably over the life of the underlying assets.⁵⁴ Specifically, utilities are generally
25 not permitted, in computing costs of service for ratemaking purposes, to refund excess plant-
26 based AFDIT more rapidly or greater than the reductions permitted by the ARAM approach,
27 which requires amortization of the excess tax reserve over the remaining regulatory lives of the

⁵² 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.

⁵³ TCJA Section 13001(d)(4).

⁵⁴ TCJA Section 13001(d)(1).

1 property that gave rise to the AFDIT.⁵⁵ If a utility’s books and records do not contain the vintage
2 data necessary to apply ARAM, the TCJA allows the utility to use an alternative method that
3 amortizes the excess plant-based AFDIT ratably over the remaining average life or composite
4 rate used to compute depreciation for regulatory purposes.⁵⁶

5 The TCJA defines ARAM as follows:

6 The average rate assumption method is the method under which the excess
7 in the reserve for deferred taxes is reduced over the remaining lives of the
8 property as used in its regulated books of account which gave rise to the
9 reserve for deferred taxes. Under such method, during the time period in
10 which the timing differences for the property reverse, the amount of the
11 adjustment to the reserve for the deferred taxes is calculated by
12 multiplying – (i) the ratio of the aggregate deferred taxes for the property
13 to the aggregate timing differences for the property as of the beginning of
14 the period in question, by (ii) the amount of the timing differences which
15 reverse during such period.⁵⁷

16
17 ARAM is computed on an asset-by-asset basis. Thus, due to the large number of SDG&E’s
18 plant-related assets, the computation is too complex and detailed to incorporate within the RO
19 Model. SDG&E instead relies on its tax accounting and depreciation software to compute the
20 ARAM amount for each year.

21 The requirement to use ARAM applies only to excess deferred taxes on plant-based
22 assets that are subject to the IRS normalization rules (also known as “protected” assets). In
23 SDG&E’s prior rate case proceedings, certain other timing differences related to plant-based
24 assets have been and continue to be treated as normalized differences, even though they fall
25 outside of the IRS definition of normalization. Since these “unprotected” plant-based timing
26 differences have been afforded normalization treatment in prior rate case decisions, SDG&E
27 proposes that an ARAM methodology should also be used to return these benefits to its
28 customers.

29 The ARAM rules under the TCJA do not discuss the individual components of plant-
30 based deferred taxes. Thus, there is uncertainty within the utility industry regarding how to treat
31 removal costs for purposes of the ARAM computation. SDG&E has discussed the issue with its

⁵⁵ TCJA Section 13001(d)(3)(B).

⁵⁶ TCJA Section 13001(d)(3)(C). SDG&E has the vintage data needed to compute ARAM and thus does not fall within this exception.

⁵⁷ TCJA Section 13001(d)(3)(A).

1 outside advisors and participated in industry group discussions regarding the proper treatment of
2 removal costs in the ARAM calculation. After its analysis and its discussions with outside
3 experts and its utility peers, SDG&E has concluded that the best interpretation of the ARAM
4 rules under the TCJA is to exclude new removal costs accrued for book purposes after December
5 31, 2017 from its ARAM calculation.⁵⁸ Since ARAM addresses historical excess tax reserves
6 (*i.e.*, pre-2018), SDG&E’s position is that only the depreciation that relates to the recovery of the
7 original cost of those capital expenditures should be included. The depreciation related to
8 recovering new cost of removal is a new timing difference arising after 2017; thus, by definition,
9 it is not a recovery of the original cost basis that gave rise to the historical excess tax reserves
10 from tax accelerated depreciation.

11 SDG&E is aware of at least one other utility that is seeking a private letter ruling from
12 the IRS on the issue of whether future removal costs should be excluded from the ARAM
13 calculation. If the IRS issues a private letter ruling on this issue, or if the IRS or Treasury release
14 other guidance on this issue, and such ruling or guidance differs from SDG&E’s position,
15 SDG&E will recalculate the ARAM adjustment to conform to such guidance. Alternatively, if
16 the Commission believes it is necessary, SDG&E could request its own private letter ruling from
17 the IRS on this issue. SDG&E proposes to reflect any such revised calculation of the ARAM
18 adjustment in its Update Testimony, or, alternatively, to track the impact of the revised
19 calculation in its TMA, depending on the timing of when such IRS or Treasury guidance is
20 issued.

21 **D. Summary Tables**

22 The following summary tables reflect the federal and state income taxes applicable to this
23 filing. The “Electric Distribution” tables, Table SDG&E-RGR-3-1 and Table SDG&E-RGR-4-
24 1, include electric distribution and electric generation for 2016.

⁵⁸ SDG&E’s position is consistent with the positions taken on this same issue by both Southern California Edison Company (SCE) and Pacific Gas and Electric Company 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).

Table SDG&E-RGR-3-1
Electric Distribution
Calculation of Federal & State Income Taxes
(\$ in Thousands)

<i>Line No.</i>	<i>Description</i>	<i>2016 Recorded</i>	<i>2017 Estimated</i>	<i>2018 Estimated</i>	<i>2019 Test Year</i>
1	Total Operating Revenue	1,313,189	1,284,807	1,284,513	1,489,537
2	O&M Expenses	(495,926)	(495,212)	(513,333)	(608,093)
3	Taxes Other than Income Taxes	(69,270)	(68,784)	(74,857)	(86,525)
4	Book Income Before Depr. & Income Taxes	747,993	720,810	696,323	794,919
5	State Tax Adjustments	(537,836)	(479,591)	(548,813)	(609,500)
6	Taxable Income	210,157	241,219	147,510	185,419
7	CCFT Rate	8.84%	8.84%	8.84%	8.84%
8	California Corporate Franchise Tax	18,578	21,324	13,040	16,391
9	Book Income Before Depr. & Income Taxes (Line 4, above)	747,993	720,810	696,323	794,919
10	Federal Tax Adjustments	(552,560)	(461,290)	(537,483)	(627,308)
11	Taxable Income	195,433	259,521	158,840	167,612
12	Federal Income Tax Rate	35%	35%	21%	21%
13	Federal Income Tax Before Credits	68,402	90,832	33,356	35,198
14	Investment Tax Credit Amortization	(2,086)	(2,319)	(1,509)	(795)
15	Average Rate Assumption Method (ARAM)	(124)	(155)	(4,981)	(5,795)
16	Other	(720)	(121)	(24)	-
17	Total Federal Income Tax	65,473	88,237	26,843	28,609

Table SDG&E-RGR-3-2
Gas Distribution
Calculation of Federal & State Income Taxes
(\$ in Thousands)

<i>Line No.</i>	<i>Description</i>	<i>2016 Recorded</i>	<i>2017 Estimated</i>	<i>2018 Estimated</i>	<i>2019 Test Year</i>
1	Total Operating Revenue	292,361	348,949	364,814	435,236
2	O&M Expenses	(156,791)	(188,773)	(197,854)	(233,568)
3	Taxes Other than Income Taxes	(14,365)	(17,254)	(19,437)	(22,151)
4	Book Income Before Depr. & Income Taxes	121,205	142,922	147,523	179,517
5	State Tax Adjustments	(99,625)	(114,015)	(123,650)	(125,748)
6	Taxable Income	21,581	28,907	23,873	53,768
7	CCFT Rate	8.84%	8.84%	8.84%	8.84%
8	California Corporate Franchise Tax	1,908	2,555	2,110	4,753
9	Book Income Before Depr. & Income Taxes (Line 4, above)	121,205	142,922	147,523	179,517
10	Federal Tax Adjustments	(89,144)	(94,928)	(106,001)	(118,948)
11	Taxable Income	32,061	47,994	41,521	60,569
12	Federal Income Tax Rate	35%	35%	21%	21%
13	Federal Income Tax Before Credits	11,221	16,798	8,720	12,719
14	Investment Tax Credit Amortization	(513)	(513)	(513)	(209)
15	Average Rate Assumption Method (ARAM)	-	-	(1,343)	(1,508)
16	Other	(51)	(17)	(3)	-
17	Total Federal Income Tax	10,658	16,268	6,860	11,003

Table SDG&E-RGR-3-3
Electric Generation
Calculation of Federal & State Income Taxes
(\$ in Thousands)

<i>Line No.</i>	<i>Description</i>	<i>2016 Recorded</i>	<i>2017 Estimated</i>	<i>2018 Estimated</i>	<i>2019 Test Year</i>
1	Total Operating Revenue	-	209,537	195,750	273,945
2	O&M Expenses	-	(70,799)	(70,156)	(101,985)
3	Taxes Other than Income Taxes	-	(13,057)	(13,186)	(15,926)
4	Book Income Before Depr. & Income Taxes	-	125,681	112,408	156,034
5	State Tax Adjustments	-	(52,837)	(65,944)	(85,902)
6	Taxable Income	-	72,845	46,464	70,132
7	CCFT Rate	8.84%	8.84%	8.84%	8.84%
8	California Corporate Franchise Tax	-	6,439	4,107	6,200
9	Book Income Before Depr. & Income Taxes (Line 4, above)	-	125,681	112,408	156,034
10	Federal Tax Adjustments	-	(64,203)	(64,405)	(89,904)
11	Taxable Income	-	61,479	48,003	66,130
12	Federal Income Tax Rate	35%	35%	21%	21%
13	Federal Income Tax Before Credits	-	21,518	10,081	13,887
14	Investment Tax Credit Amortization	-	-	-	-
15	Average Rate Assumption Method (ARAM)	-	-	-	-
16	Other	-	-	-	-
17	Total Federal Income Tax	-	21,518	10,081	13,887

Table SDG&E-RGR-4-1
Electric Distribution
Summary of Income Tax Adjustments
(\$ in Thousands)

<i>Line No.</i>	<i>Description</i>	<i>2016 Recorded</i>	<i>2017 Estimated</i>	<i>2018 Estimated</i>	<i>2019 Test Year</i>
<u>Federal Tax Adjustments:</u>					
1	Tax Depreciation ⁵⁹	(264,964)	(242,709)	(264,351)	(324,594)
2	Fixed Charges – Operating	(91,166)	(81,407)	(82,088)	(93,913)
3	Repairs	(81,226)	(76,708)	(118,058)	(154,445)
4	Software Development	(60,759)	(37,301)	(42,699)	(28,335)
5	Cost of Removal	(6,072)	(5,279)	(5,279)	(5,279)
6	Ad Valorem Tax - Fiscal/Calendar	(8,107)	(2,029)	(3,685)	(7,702)
7	Section 199 Deduction	-	-	-	-
8	Credit Addback & Other	35	-	-	-
9	Prior Year Calif. Corp. Franchise Tax	(40,300)	(15,857)	(21,324)	(13,040)
10	Total Federal Tax Adj. (Deduction)	<u>(552,560)</u>	<u>(461,290)</u>	<u>(537,483)</u>	<u>(627,308)</u>
<u>State Tax Adjustments:</u>					
11	Tax Depreciation	(252,870)	(241,919)	(261,904)	(284,686)
12	Fixed Charges – Operating	(90,833)	(81,126)	(81,861)	(93,703)
13	Repairs	(81,226)	(76,708)	(118,058)	(154,445)
14	Software Development	(60,759)	(37,301)	(42,699)	(28,335)
15	Cost of Removal	(44,318)	(40,630)	(40,630)	(40,630)
16	Ad Valorem Tax - Fiscal/Calendar	(8,107)	(2,029)	(3,685)	(7,702)
17	Credit Addback & Other	278	121	24	-
18	Total State Tax Adj. (Deduction)	<u>(537,836)</u>	<u>(479,591)</u>	<u>(548,813)</u>	<u>(609,500)</u>

⁵⁹ As discussed in SDG&E's Revised Tax Testimony served on December 20, 2017, SDG&E discovered an error in the electric distribution "Tax Depreciation" amounts for 2016 – 2019 shown in Table SDG&E-RGR-4-1 of the Revised Tax Testimony, which caused the Tax Depreciation amount for TY 2019 to be overstated. This revised Table SDG&E RGR-4-1 reflects the correction of that error.

Table SDG&E-RGR-4-2
Gas Distribution
Summary of Income Tax Adjustments
(\$ in Thousands)

<i>Line No.</i>	<i>Description</i>	<i>2016 Recorded</i>	<i>2017 Estimated</i>	<i>2018 Estimated</i>	<i>2019 Test Year</i>
<u>Federal Tax Adjustments:</u>					
1	Tax Depreciation	(40,473)	(45,900)	(52,787)	(67,661)
2	Fixed Charges – Operating	(14,852)	(17,294)	(18,112)	(21,707)
3	Repairs	(14,403)	(13,678)	(13,678)	(13,678)
4	Software Development	(9,797)	(15,382)	(17,608)	(11,684)
5	Cost of Removal	(295)	(279)	(279)	(279)
6	Ad Valorem Tax - Fiscal/Calendar	(1,314)	(488)	(982)	(1,828)
7	Section 199 Deduction	-	-	-	-
8	Credit Addback & Other	6	-	-	-
9	Prior Year Calif. Corp. Franchise Tax	(8,016)	(1,908)	(2,555)	(2,110)
10	Total Federal Tax Adj. (Deduction)	<u>(89,144)</u>	<u>(94,928)</u>	<u>(106,001)</u>	<u>(118,948)</u>
<u>State Tax Adjustments:</u>					
11	Tax Depreciation	(57,181)	(65,064)	(71,135)	(74,707)
12	Fixed Charges – Operating	(14,823)	(17,276)	(18,107)	(21,706)
13	Repairs	(14,403)	(13,678)	(13,678)	(13,678)
14	Software Development	(9,797)	(15,382)	(17,608)	(11,684)
15	Cost of Removal	(2,151)	(2,144)	(2,144)	(2,144)
16	Ad Valorem Tax - Fiscal/Calendar	(1,315)	(488)	(982)	(1,828)
17	Credit Addback & Other	45	17	3	-
18	Total State Tax Adj. (Deduction)	<u>(99,625)</u>	<u>(114,015)</u>	<u>(123,650)</u>	<u>(125,748)</u>

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Table SDG&E-RGR-4-3
Electric Generation
Summary of Income Tax Adjustments
(\$ in Thousands)

<i>Line No.</i>	<i>Description</i>	<i>2016 Recorded</i>	<i>2017 Estimated</i>	<i>2018 Estimated</i>	<i>2019 Test Year</i>
<u>Federal Tax Adjustments:</u>					
1	Tax Depreciation	-	(43,057)	(44,258)	(63,755)
2	Fixed Charges – Operating	-	(14,921)	(13,651)	(19,363)
3	Repairs	-	-	-	-
4	Software Development	-	-	-	-
5	Cost of Removal	-	-	-	-
6	Ad Valorem Tax - Fiscal/Calendar	-	(19)	(55)	(2,679)
7	Section 199 Deduction	-	(3,484)	-	-
8	Credit Addback & Other	-	-	-	-
9	Prior Year Calif. Corp. Franchise Tax	-	(2,721)	(6,439)	(4,107)
10	Total Federal Tax Adj. (Deduction)	-	(64,203)	(64,405)	(89,904)
<u>State Tax Adjustments:</u>					
11	Tax Depreciation	-	(37,896)	(52,237)	(63,860)
12	Fixed Charges – Operating	-	(14,921)	(13,651)	(19,363)
13	Repairs	-	-	-	-
14	Software Development	-	-	-	-
15	Cost of Removal	-	-	-	-
16	Ad Valorem Tax - Fiscal/Calendar	-	(19)	(55)	(2,679)
17	Credit Addback & Other	-	-	-	-
18	Total State Tax Adj. (Deduction)	-	(52,837)	(65,944)	(85,902)

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E. Results

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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 R. Craig Gentes, Exhibit SDG&E-33-2R, for a discussion of rate base). Federal and state tax adjustments are also growing annually which, in turn, partially offsets the growth in book income before taxes from 2016 to TY 2019.

1 **F. Tax Memorandum Account**

2 **1. Background**

3 In SDG&E’s 2016 GRC Decision,⁶⁰ the Commission instructed SDG&E to establish a
4 TMA for the 2016 GRC cycle (January 1, 2016 – December 31, 2018).⁶¹ As stated by the
5 Commission, the purpose of the TMA “is to increase the transparency of the utilities’ incurred
6 and forecasted income tax expenses to the Commission, so that the Commission can more
7 closely examine the revenue impacts caused by the utilities’ implementation of various tax laws,
8 tax policies, tax accounting changes, or tax procedure changes.”⁶² The TMA “shall remain open
9 and the balance in the account shall be reviewed in every subsequent GRC proceeding until a
10 Commission decision closes the account.”⁶³

11 Pursuant to the Commission’s directives, SDG&E filed Advice Letter No. 2928-E-
12 A/2496-G-A on September 16, 2016 to establish the TMA. As further discussed in the testimony
13 of SDG&E witness Norma Jasso (Exhibit SDG&E-41), the TMA is a two-way tracking account
14 that separately tracks the revenue requirement impact of the differences between tax expenses
15 forecasted and tax expenses incurred resulting from: (1) net revenue changes resulting from
16 differences between forecasted federal and state tax adjustments and tax credits to incurred
17 federal and state tax adjustments and tax credits; (2) mandatory tax law changes, tax accounting
18 changes, tax procedural changes, and tax policy changes; (3) elective tax law changes, tax
19 accounting changes, tax procedural changes, and tax policy changes; (4) the completion of audits
20 by federal and state taxing authorities; and (5) the implementation of any IRS private letter ruling
21 regarding compliance with IRS normalization regulations.

22 The Commission approved Advice Letter No. 2928-E-A/2496-G-A on December 5,
23 2016. Consistent with D.16-06-054, SDG&E is tracking and will continue to track the items in
24 the TMA in accordance with the provisions of Advice Letter No. 2928-E-A/2496-G-A until such
25 time that the Commission closes the account.

⁶⁰ D.16-06-054.

⁶¹ *Id.* at Ordering Paragraph 4.

⁶² *Id.* at 196.

⁶³ *Id.*

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

3 In its final decision in Pacific Gas and Electric Company’s (PG&E’s) 2017 GRC, the
4 CPUC instructed PG&E to establish a TMA “consistent with our identical orders in the SDG&E
5 and SoCalGas Test Year 2016 proceeding.”⁶⁴ The stated purpose, terms, and requirements of
6 PG&E’s TMA were identical to what the CPUC had ordered in SDG&E’s 2016 GRC Decision.⁶⁵

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

12 **a. CPUC’s Policy on True Up of Income Taxes**

13 The CPUC held in OII 24 that the impact of tax adjustments in excess of or below what
14 was forecasted in the GRC generally should not be trued up.⁶⁶ In its decision, the CPUC
15 explained the view expressed by both CPUC staff and Industry representatives that seeking a
16 change from this general ratemaking policy for a particular, isolated tax item would not be
17 appropriate:

18 Staff and Industry agree . . . that differences in income taxes between
19 estimated and actual cannot be isolated from other factors in determining
20 whether an adjustment should be made to the test-year estimate. Any
21 review of differences would have to include the effects of differences of
22 all estimates for revenues, operating expenses, income taxes and return on
23 investment. Any prospective adjustment based on past over- or
24 underestimates would have to take into consideration the overall effect of
25 the differences for all components of the test-year. Under these
26 circumstances parties recommend no change in the present ratemaking
27 procedure.⁶⁷

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

⁶⁴ D.17-05-013 at 116.

⁶⁵ *Id.* at 116-117.

⁶⁶ *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.”).

⁶⁷ *Id.* at *33.

1 Since income taxes are derived residually, we agree that individual factors
2 should not be isolated for purposes of comparing estimated and recorded
3 results. Obviously, if the utility earnings are substantially less than
4 authorized, then a comparison of estimated and actual income taxes is
5 misleading. Moreover, an across-the-board comparison of estimated and
6 recorded results is not useful for any purpose other than informational,
7 because it is consistent with test-year ratemaking.⁶⁸

8 **b. CPUC’s Response to PG&E’s Comments**

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

12 PG&E’s arguments rely on an incomplete reading of D.84-05-036 to
13 oppose an outcome that is not, in fact, part of the APD. The Commission
14 begins D.84-05-036 with an explanation that “[i]n the order that instituted
15 this investigation we stated “the determination of reasonable allowable
16 ratemaking expenses for federal and state income taxes is a matter of
17 continuing concern to this Commission in its effort to establish reasonable
18 utility rates.” The Commission then addresses a number of specific
19 questions with respect to taxes and appropriate ratemaking policies.
20 PG&E cites D.84-05-036 and asserts that “[t]he Commission
21 acknowledged that differences between estimated and recorded tax
22 deductions and correspondingly estimated and recorded tax expense will
23 occur in the ratemaking process and concluded that a true-up mechanism
24 for taxes is not good policy.” While the Commission does decline to
25 “require utilities to submit adjustments reflecting reductions in taxes”, it
26 qualifies this result by stating “[w]e agree that changes in tax laws may be
27 taken into account in ratemaking”. The APD does not adopt any sort of
28 “true-up mechanism”—rather, it adopts a mechanism that will provide the
29 Commission with the information that it needs so that “changes in tax laws
30 may be taken into account in ratemaking.” PG&E appears concerned that
31 the APD adopts what PG&E terms an “actual taxes” standard, stating “[i]n
32 light of the widely recognized problems inherent in an actual taxes
33 standard, it would be expected that a change in policy be preceded by a
34 well-articulated explanation; however, the APD makes no reference to OII
35 24, let alone an attempt to rationalize the APD’s outcome against the
36 instruction in OII 24.” Again, the APD makes no such change in policy.⁶⁹

⁶⁸ *Id.* at *34.

⁶⁹ D.17-05-013 at 226-227 (citations omitted).

1 Accordingly, the CPUC clearly articulated in its decision in the PG&E 2017 GRC that
2 the purpose and intent of the TMA is not to true up forecasted taxes to actual taxes, but rather to
3 gain a better understanding of and visibility into “the revenue impacts caused by the utilities’
4 implementation of various tax laws, tax policies, tax accounting changes, or tax procedure
5 changes.”⁷⁰

6 **3. 2016 TMA Balances**

7 Based on the foregoing and in accordance with D.16-06-054, SDG&E presents the 2016
8 TMA balance. A schedule that shows the TMA balances for 2016 (TMA Schedule) is attached
9 as Appendix B. In order to provide additional transparency to the CPUC, and consistent with the
10 CPUC’s clarifications regarding the purpose and scope of the TMA as articulated in PG&E’s
11 2017 GRC decision, the TMA Schedule separates the amount for each line item between: (a) the
12 impact of differences between forecasted and incurred amounts related to changes in tax law, tax
13 accounting, tax procedure, or tax policy, holding all other forecast items constant; and (b) the
14 impact of differences not related to changes in tax law, tax accounting, tax procedure, or tax
15 policy (*i.e.*, differences caused by differences in revenue, capital expenditures, the timing of
16 when an asset is placed in service, etc.), holding all other forecast items constant. If the change
17 in tax expense would decrease revenue, the amount is shown as a credit. If the change in tax
18 expense would increase revenue, the amount is shown as a debit. Each line item in the TMA
19 Schedule is discussed in turn, below.

20 **a. Net Revenue Changes**

21 The definition and scope of the “Net Revenue Changes” tracking item ordered by the
22 Commission is unclear to SDG&E. SDG&E has interpreted “Net Revenue Changes” to mean
23 the revenue impact of differences between incurred and authorized 2016 amounts for all income
24 tax adjustments and credits.⁷¹ As shown in the TMA Schedule, none of these differences for
25 2016 were caused by changes in tax law, tax accounting, tax procedure, or tax policy. Rather,

⁷⁰ D.16-06-054 at 196; *see also* D.17-05-013 at 116-117.

⁷¹ During a telephone call on August 1, 2017, the Commission’s Energy Division provided clarifying guidance to SDG&E 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.

1 the differences between the incurred and authorized amounts were derived from residual factors
2 outside of tax and thus represent the type of tax “true-up” discussed and rejected in OII 24.

3 **b. Completion of Audits**

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

5 **c. IRS Rulings on Normalization Issues**

6 There was no revenue impact from IRS Private Letter Rulings on normalization issues in
7 2016.

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

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

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

14 There was no revenue impact from elective changes in tax law, tax procedures or tax
15 policy in 2016.⁷²

16 SDG&E has not made any tax accounting method changes for 2016 as of the date of this
17 Application;⁷³ however, during 2016, SDG&E adopted Accounting Standard Update (ASU)
18 2016-09 – Improvements to Employee Share-based Payment Accounting, issued by Financial
19 Accounting Standards Board (FASB) in March 2016. The FASB issued this ASU to simplify
20 several aspects of the accounting for employee share-based payment transactions. Under ASU
21 2016-09, excess tax benefits and tax deficiencies, which represent the difference between the tax
22 return deduction amounts and the compensation cost recognized for financial reporting purposes,
23 are required to be recognized as income tax expense or benefit in the income statement instead of
24 in additional paid-in-capital (APIC) on the balance sheet. This book accounting change does not
25 impact or change the deduction or loss companies take on their tax returns relating to the share-
26 based payments.

⁷² The impact of the bonus depreciation extension under the PATH Act was incorporated in SDG&E’s 2016 GRC Decision; therefore, there is no 2016 impact to track for the PATH Act legislation since SDG&E’s 2016 GRC Decision reflects the 2016 50% bonus depreciation rate for the GRC period (*i.e.*, through 2018).

⁷³ Subsequent to filing its Application, SDG&E made a tax accounting method change for its 2016 tax return to change the timing of when certain deductions could be claimed. There is no revenue impact to SDG&E’s ratepayers related to this tax accounting method change. SDG&E notified the Commission of this tax accounting method change by letter to the Executive Director on December 19, 2017.

1 ASU 2016-09 does not require any filing with or permission from the IRS or other taxing
2 authority to implement; rather, it is purely a book accounting change under Generally Accepted
3 Accounting Principles (GAAP). Therefore, the adoption of ASU 2016-09 is likely outside the
4 definition of the items that the CPUC ordered SDG&E to track in its TMA. SDG&E believes,
5 however, that including the revenue impact of this book accounting change is consistent with the
6 CPUC's desire to increase transparency and visibility of accounting elections that potentially
7 impact revenues; therefore, SDG&E has tracked the 2016 revenue impact of the book accounting
8 change, as reflected in the TMA Schedule.

9 The book expense relating to the share-based payments, also called the Long Term
10 Incentive Plan (LTIP), has not been included in the GRC revenue requirement approved by the
11 CPUC since 2008, and thus the entire costs of the LTIP has been borne by the shareholders since
12 2008. Accordingly, the majority of tax benefit recognized as tax expense on the income
13 statement in 2016 from SDG&E's adoption of ASU 2016-09 was funded by shareholders. There
14 was, however, a portion of the tax benefit recognized in 2016 related to stock options issued
15 prior to 2008. Specifically, in its 2004 GRC, SDG&E was granted 50% recovery of the LTIP
16 costs through rates, and the remaining 50% of the LTIP costs were determined to be shareholder-
17 funded.⁷⁴ The revenue requirement impact of the ratepayer-funded portion of the tax benefit
18 from the LTIP costs in SDG&E's 2004 GRC is reflected in the TMA Schedule.⁷⁵

19 **4. Proposal for 2019 GRC Cycle**

20 During SDG&E's 2019 GRC cycle, SDG&E will continue to notify the Commission of
21 any tax-related law changes, accounting changes, policy changes, or procedural changes that
22 materially affect (or may materially affect) revenues,⁷⁶ and will continue to report the revenue
23 impact of any such changes to the Commission. SDG&E believes that continuing to notify the
24 Commission of such changes and the corresponding revenue impact during the 2019 GRC cycle
25 is consistent with the CPUC's policy goals of gaining better visibility into the utilities' elections
26 of various tax options, as stated by the Commission in SDG&E's 2016 GRC Decision and as
27 reiterated and clarified in PG&E's 2017 GRC Decision. Accordingly, SDG&E believes a TMA

⁷⁴ See D.04-12-015.

⁷⁵ As discussed earlier, SDG&E 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.

⁷⁶ Consistent with SDG&E's 2016 GRC Decision, "materially affect" for this purpose means a potential increase or decrease of \$3 million or more.

1 is no longer necessary and requests that the Commission eliminate the TMA for SDG&E's 2019
2 GRC cycle.

3 If the Commission disagrees with SDG&E and believes that a TMA is necessary for the
4 2019 GRC cycle, SDG&E proposes that the Commission reaffirm that the TMA is not intended
5 to be a true-up mechanism for taxes (and thus is not intended to track the differences between
6 forecasted and actual tax deductions that are caused by factors outside of tax and are unrelated to
7 changes in tax law, tax accounting methods, tax procedures, or tax policy), but is intended to
8 track the revenue impact of changes in tax law, tax accounting methods, tax procedures, and tax
9 policy. Such a reaffirmation would be consistent with the Commission's long-standing policy of
10 not trueing-up differences between forecasted and actual tax deductions, as articulated by the
11 Commission in OII 24 and in D.17-05-013. Accordingly, the differences, positive or negative,
12 between forecasted and actual tax expenses caused by derivative factors outside of tax and
13 unrelated to changes in tax law, tax accounting methods, tax procedures, or tax policy would
14 continue to flow to SDG&E's bottom line for each taxable year, consistent with the
15 Commission's long-standing policy.⁷⁷ If the Commission is considering changing its long-
16 standing policy on taxes and adopting an actual taxes standard, SDG&E believes that the
17 Commission should first initiate an Order Instituting Rulemaking (OIR) or other regulatory
18 proceeding with all the utilities under the Commission's jurisdiction to evaluate the potential
19 impact of such a policy change.

20 **V. FRANCHISE FEES**

21 **A. Introduction**

22 The purpose of this section is to provide background and analysis for SDG&E's
23 Franchise Fees as estimated for TY 2019.

24 **B. Discussion**

25 Franchise fees are payments made to counties and incorporated cities pursuant to local
26 ordinances granting a franchise to the company to place utility property in the public rights of
27 way. These facilities include poles, wires, conduits, and appurtenances for transmitting and
28 distributing electricity, and pipes and appurtenances for transmitting and distributing gas.
29 Franchise fees attributable to income from transmitting electricity are excluded from the

⁷⁷ See 1984 Cal. PUC LEXIS 1325 at *33-34.

1 following franchise fee calculations. As of January 1, 2017, SDG&E had franchise fee
2 agreements with 28 taxing jurisdictions.

3 The franchise fee requirements are based upon gross receipts representing the recovery of
4 base margin. The franchise factors upon which the estimated 2017-2019 franchise fees were
5 determined are based on a summary of 2016 electric and gas sales, transportation revenues, rate
6 refunds, and uncollectibles. The factors were adjusted to forecasted 2019 levels based on
7 historical trends in franchise payment data.

8 Franchises are calculated using two formulas: (1) the “Broughton Act” formula, and (2)
9 the “Percent of Gross Receipts” formula. The Broughton Act formula, as prescribed by CPUC
10 guidelines, is calculated based upon the summarized receipts within each city or county as
11 allocated by electric pole line and gas pipeline mileage in their public rights of way, and the
12 applicable franchise fee rate pursuant to the franchise fee ordinance. The Percent of Gross
13 Receipts formula is calculated based upon the summarized receipts within each city or county,
14 and the applicable franchise fee rate pursuant to the franchise fee ordinance.

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

20 The total payments to all taxing authorities were summed and divided by total receipts to
21 arrive at system-wide franchise fee factors for electric and gas. The system-wide franchise fee
22 factors for the most recent five years were then averaged to yield forecasted average franchise
23 fee factors for TY 2019. The average electric franchise fee factor for TY 2019 is projected to be
24 3.4468% based on the trend from actual 2012-2016 franchise fees. The average gas franchise fee
25 factor for TY 2019 is projected to be 2.0799%, likewise based on the trend from actual 2012-
26 2016 franchise fees.⁷⁸

⁷⁸ 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.

1 **C. Summary of Estimated Franchise Fees**

2 Table SDG&E-RGR-5-1 below provides the Franchise Fees as estimated for TY 2019.

3 **Table SDG&E-RGR-5-1**

(\$ in Thousands)

Franchise Fees	Line No.	2016 Recorded	2017 Estimated	2018 Estimated	2019 Test Year
Electric Distribution	1	44,848	43,828	43,778	50,836
Gas Distribution	2	6,086	7,196	7,529	8,993
Electric Generation	3	0	7,222	6,747	9,442

4 **D. Results**

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

7 **VI. CONCLUSION**

8 This concludes my prepared direct testimony.

1 **VII. WITNESS QUALIFICATIONS**

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

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

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

14 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
Regs: Treasury Regulations
SBE: California State Board of Equalization
SDG&E: San Diego Gas & Electric 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**

SDG&E																
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 <u>NOT</u> 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			
	Electric	Gas	Total	Electric	Gas	Total	Electric	Gas	Total	Electric	Gas	Total	Electric	Gas	Total	
1) Incurred vs Authorized Tax Adjustments and Credits																
Federal and State Tax Adjustments and Credits	(29,997)	(5,335)	(35,331)	(23,276)	(5,068)	(28,344)	(6,721)	(267)	(6,987)	(6,721)	(267)	(6,987)	0	0	0	[a]
Federal Tax Impact of California Franchise Tax	2,397	865	3,262	695	462	1,157	1,702	403	2,106	1,702	403	2,106	0	0	0	[b]
After-Tax Differences	(27,600)	(4,469)	(32,069)	(22,581)	(4,606)	(27,187)	(5,018)	137	(4,882)	(5,018)	137	(4,882)	0	0	0	[c] = [a] + [b]
Gross-Up Rate Applied to Differences										1.68746	1.68746	1.68746	1.68746	1.68746	1.68746	[d]
Subtotal										(8,469)	231	(8,238)	-	-	-	[e] = [c] * [d]
Impact of Corrollary Basis Adjustments										(62)	39	(24)	-	-	-	[f]
Impact of Net Operating Loss ("NOL") Carryforwards	0	0	0	0	0	0	-	-	-	-	-	-	-	-	-	[g]
Revenue Impact of Differences										(8,531)	269	(8,262)	0	0	0	[h] = [e] + [f] + [g]
2) Adjustments due to Completion of Audits																
None										0	0	0	0	0	0	[i]
3) Adjustments due to IRS Private Letter Rulings on																
None										0	0	0	0	0	0	[j]
4) Mandatory Changes in Tax Law, Tax Accounting, Tax Procedures, or Tax Policy																
None										0	0	0	0	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:																
Federal and State Tax Impact										-	-	-	(27)	(11)	(38)	[l]
Gross-Up Rate										1.68746	1.68746	1.68746	1.68746	1.68746	1.68746	[m]
Revenue Impact of Change										0	0	0	(45)	(19)	(64)	[n] = [l] * [m]
Total Revenue Impact of Differences/Changes										(8,531)	269	(8,262)	(45)	(19)	(64)	[o] = [h] + [i] + [j] + [k] + [n]
Interest (Payable)/Receivable										(1)	0	(1)	-	-	-	[p]
Ending Balance (Credit)/Debit										(8,532)	269	(8,263)	(45)	(19)	(64)	[q] = [o] + [p]

SDG&E 2019 GRC Testimony Revision Log – April 6, 2018

Exhibit	Witness	Page	Line or Table	Revision Detail
SDG&E-35	Ragan G. Reeves	RGR-iii	2 nd bullet point	Changed income tax expense from “\$152.0 million” to “\$80.8 million”; Changed ad valorem tax expense from “\$102.1 million” to “\$106.2 million”; and Changed franchise fees from “\$69.2 million” to “\$69.3 million”
SDG&E-35	Ragan G. Reeves	RGR-iii	4 th 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 SDG&E 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.”
SDG&E-35	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 SDG&E files its federal and California 2017 income tax returns. SDG&E expects to file those tax returns in October 2018.”
SDG&E-35	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
SDG&E-35	Ragan G. Reeves	RGR-5	Lines 13-15	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
SDG&E-35	Ragan G. Reeves	RGR-5	Lines 21-23	Modified as follows: <u>“The UI rate decreased to 3% for 2017. Based on currently enacted law, the UI tax rate is expected to decrease to remain at 3.0% for 20178 and 2019.</u> ”
SDG&E-35	Ragan G. Reeves	RGR-5	Footnote 10	Modified as follows: <u>“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, SDG&E will update its 2019 payroll tax forecast in its Update Testimony filing (consistent with SDG&E’s approach in prior GRCs).</u>”</u>
SDG&E-35	Ragan G. Reeves	RGR-9	Table SDG&E-RGR-2-1	Revised table
SDG&E-35	Ragan G. Reeves	RGR-10	Table SDG&E-RGR-2-2	Revised table
SDG&E-35	Ragan G. Reeves	RGR-11	Table SDG&E-RGR-2-3	Revised table
SDG&E-35	Ragan G. Reeves	RGR-12	Lines 9-10	Modified as follows: <u>“This section also presents the 2016 results of the TMA as of the date of this Application.”</u> 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.”

Exhibit	Witness	Page	Line or Table	Revision Detail
SDG&E-35	Ragan G. Reeves	RGR-13	Lines 6-11	Modified as follows: “ <u>For 2016 and 2017, SDG&E has utilized current 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, SDG&E 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> ”
SDG&E-35	Ragan G. Reeves	RGR-14	Line 1	Modified as follows: “Consistent with CPUC policy, where normalization is not required by the IRC, SDG&E <u>generally</u> has employed flow-through accounting.”
SDG&E-35	Ragan G. Reeves	RGR-14	Lines 12-20; Footnote 25	Modified as follows: “SDG&E’s 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% <u>prior to the Tax Reform Act of 1986 (TRA 86)</u> to the current 35% beginning in 1993 <u>21% under the TCJA beginning in 2018</u> , utilizing the Average Rate Assumption Method (ARAM) as required by Internal Revenue Service (IRS) normalization rules and mandated by D.88-01-061. <u>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.</u> Added new footnote 25: “TCJA Section 13001(d)(3)(B).”
SDG&E-35	Ragan G. Reeves	RGR-14	Line 21	Modified as follows: “ The Tax Reform Act of 1986 (TRA 86)... ”
SDG&E-35	Ragan G. Reeves	RGR-15	Line 2	Modified as follows: “As prescribed by the CPUC in D.84-05-036, SDG&E used the statutory federal tax rate of 35% <u>for 2016-2017 and 21% for 2018-2019</u> , and the statutory state tax rate of 8.84% <u>in its development of the net-to-gross multiplier used to gross-up tax expense to a revenue requirement.</u> ”

Exhibit	Witness	Page	Line or Table	Revision Detail
SDG&E-35	Ragan G. Reeves	RGR-16 to RGR-17	Line 20 to Line 4	Modified as follows: “SDG&E follows the guidance in IRS Revenue Ruling 2000-7, which provides a current tax deduction for actual costs to remove assets retired from service <u>in the year that those costs are incurred.</u> For book purposes, <u>estimates of such costs are capitalized and depreciated over the life of the assets.</u> <u>Thus, there is a timing difference between tax and book.</u> 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, SDG&E 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 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.9384 prior GRCs.”
SDG&E-35	Ragan G. Reeves	RGR-17	Line 8	Added sentence: “This treatment is consistent with prior GRCs.”
SDG&E-35	Ragan G. Reeves	RGR-17	Lines 13-16; Footnote 33	Modified as follows: “ <u>The TCJA eliminated the Section 199 deduction beginning with the 2018 tax year.</u> Accordingly, SDG&E has calculated a Section 199 deduction for its qualified production of electricity in its calculation of income tax expense <u>for 2016 and 2017 only.</u> The deduction <u>for those years</u> is limited to the lesser of 9% of income from the production of electricity or 50% of wages paid to employees engaged in the production of electricity.” Added new footnote 33: “TCJA Section 13305(a).”
SDG&E-35	Ragan G. Reeves	RGR-17 to RGR-18	Line 29 to Line 1	Modified as follows: “see the testimony of R. Craig Gentes, Exhibit SDG&E-33- <u>2R</u> , for a discussion of rate base.”
SDG&E-35	Ragan G. Reeves	RGR-18	Line 8	Added new subheading: “a. Extension under the PATH Act”

Exhibit	Witness	Page	Line or Table	Revision Detail
SDG&E-35	Ragan G. Reeves	RGR-19	Line 16	Modified as follows: "...the extra bonus depreciation multiplied by the 35% federal income..."
SDG&E-35	Ragan G. Reeves	RGR-19	Lines 19-20	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 ..."
SDG&E-35	Ragan G. Reeves	RGR-19 to RGR-21	Line 26 to Line 19	Added new subsection IV.C.1.b – Changes to the Bonus Depreciation Rules under the TCJA
SDG&E-35	Ragan G. Reeves	RGR-22 to RGR-24	Line 9 to Line 20	Added new subsection IV.C.3 – Excess Deferred Taxes Related to the TCJA
SDG&E-35	Ragan G. Reeves	RGR-25	Table SDG&E-RGR- 3-1	Revised table
SDG&E-35	Ragan G. Reeves	RGR-26	Table SDG&E-RGR- 3-2	Revised table
SDG&E-35	Ragan G. Reeves	RGR-27	Table SDG&E-RGR- 3-3	Revised table
SDG&E-35	Ragan G. Reeves	RGR-28	Table SDG&E-RGR- 4-1	Revised table

Exhibit	Witness	Page	Line or Table	Revision Detail
SDG&E-35	Ragan G. Reeves	RGR-28	Table SDG&E-RGR-4-1	Deleted footnote 35, which read: “SDG&E has discovered an error in the electric distribution “Tax Depreciation” amounts for 2016 – 2019 shown in Table SDG&E-RGR-4-1, which causes the Tax Depreciation amount for TY 2019 to be overstated. Due to the timing of the discovery of this error, SDG&E is choosing not to correct the error at this time. SDG&E reserves the right to correct this error in an update filing or in a subsequent revised filing, or at some other time that the Commission deems appropriate.”
SDG&E-35	Ragan G. Reeves	RGR-28	Table SDG&E-RGR-4-1	Added new footnote 60, which states: “As discussed in SDG&E’s Revised Tax Testimony filed on December 20, 2017, SDG&E discovered an error in the electric distribution “Tax Depreciation” amounts for 2016 – 2019 shown in Table SDG&E-RGR-4-1 of the Revised Tax Testimony, which caused the Tax Depreciation amount for TY 2019 to be overstated. This revised Table SDG&E RGR-4-1 reflects the correction of that error.”
SDG&E-35	Ragan G. Reeves	RGR-29	Table SDG&E-RGR-4-2	Revised table
SDG&E-35	Ragan G. Reeves	RGR-30	Table SDG&E-RGR-4-3	Revised table
SDG&E-35	Ragan G. Reeves	RGR-30	Lines 3-8	Modified as follows: “The increase <u>overall decrease</u> in federal and state income tax expense from 2016 to TY 2019 is primarily a function of <u>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</u> (see the testimony of R. Craig Gentes, Exhibit SDG&E-33- 2R , for a discussion of rate base). Federal and state tax adjustments are also growing annually <u>which, in turn,</u> partially offsetting the growth in book income before taxes from 2016 to TY 2019.”

Exhibit	Witness	Page	Line or Table	Revision Detail
SDG&E-35	Ragan G. Reeves	RGR-35	Footnote 73	Modified footnote to delete last sentence, which read: "SDG&E 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%. SDG&E will track any such revenue impact in its TMA for 2018."
SDG&E-35	Ragan G. Reeves	RGR-35	Footnote 74	Modified footnote to add the last sentence, which reads: "SDG&E notified the Commission of this tax accounting method change by letter to the Executive Director on December 19, 2017."
SDG&E-35	Ragan G. Reeves	RGR-39	Table SDG&E-RGR- 5-1	Revised table