Company: San Diego Gas & Electric Company (U 902 M)
Proceeding: 2024 General Rate Case
Application: A.22-05-016
Exhibit: SDG&E-37-R

REVISED

PREPARED DIRECT TESTIMONY OF

RAGAN G. REEVES

(TAX)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

August 2022

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SDG&E 2024 GRC Testimony Revision Log –August 2022

SUMMARY

- My testimony presents San Diego Gas & Electric Company's (SDG&E) estimated tax expense for Test Year (TY) 2024 and explains how those estimates were derived. The tax expenses discussed in my testimony include payroll taxes, ad valorem taxes, and income taxes.
- My testimony estimates a TY 2024 payroll tax expense of $22.2 million, ad valorem tax expense of $165.4 million, and income tax expense of $158.3 million.
- 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 Section (IRC §) 199 deduction beginning in 2018; (4) the elimination of the deduction for transportation fringe benefits provided to employees beginning in 2018; (5) 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; and (6) a change in the tax treatment of self-developed software costs from being fully deductible in the year the costs are incurred to, beginning in 2022, a five-year amortization period for deducting such costs.

REVISED PREPARED DIRECT TESTIMONY OF
RAGAN G. REEVES
(TAX)

I. INTRODUCTION

A. Summary of Proposals

My testimony presents SDG&E's estimated tax expense for TY 2024 and explains how those estimates were derived. My testimony also presents the cumulative balances of the Tax Memorandum Account (TMA) as of December 31, 2021.

B. Organization of Testimony

SDG&E incurs three categories of taxes: (1) payroll taxes; (2) ad valorem (*i.e.*., property) taxes; and (3) income taxes. I will discuss each of these tax expense categories in turn.[1] A summary table for each category of tax expense is presented at the end of each section.[2]

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

II. PAYROLL TAXES

A. Introduction

The purpose of this section is to provide an estimate of SDG&E's 2024 payroll tax expenses, and to describe the methodology used to develop SDG&E's estimate.

B. Discussion

Payroll taxes were estimated by applying a tax rate on TY 2024 O&M and capital labor covered in this Application up to a maximum wage base. Payroll taxes are paid by both the employee and the employer. The following discussion relates to the employer's payroll tax liability.

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[1] The TMA discussion is included within the Income Taxes section of my testimony.

[2] Unless otherwise indicated, the computation of tax expense in my testimony and workpapers reflects only the amounts related to assets, projects, and activities that are included as part of this General Rate Case (GRC), and does not reflect revenues and expenses that are recovered through separate filings before the Commission or the Federal Energy Regulatory Commission (FERC).

1. **Federal Insurance Contributions Act**

Federal Insurance Contributions Act (FICA) taxes, also referred to as social security taxes, are composed of two pieces: (1) the Old-Age, Survivors, and Disability Insurance (OASDI); and (2) the Hospital Insurance (HI or Medicare). For 2021, the OASDI tax rate was 6.2% of wages up to a maximum wage base of $142,800. The Medicare tax rate was 1.45% of wages with no maximum wage base. Based on rate schedules contained in the 2021 Annual Report published by the Social Security Administration (2021 Annual Report), the employer's portion of the OASDI and Medicare tax rates have been at current levels since 1990 and are not expected to change through 2024 based on currently enacted law.[3] The OASDI wage base is $147,000 for 2022 and is projected to increase to $156,000 for 2023 and $162,900 for 2024 based on data reported in the 2021 Annual Report.[4]

2. **Federal Unemployment Tax Act**

The Federal Unemployment Tax Act (FUTA) tax rate is 0.6% for 2021 and 2022 on wages up to $7,000. Based on currently enacted law, the FUTA tax rate is expected to remain at 0.6% for 2023 and 2024, and the FUTA wage base is expected to remain at $7,000 through 2024.

3. **California State Unemployment Insurance**

The California State Unemployment Insurance (SUI) is composed of two pieces: (1) the Unemployment Insurance (UI), and (2) the California Employment Training Tax (CET). The UI tax rate on wages up to $7,000 for 2021 and 2022 is 1.7% and 1.5% respectively. The CET tax rate for 2021 and 2022 is an additional 0.1% on wages up to $7,000. Based on currently enacted law, the UI tax rate is expected to remain at 1.5% for 2023 and 2024. The CET tax rate and wage bases for SDG&E are not expected to change through 2024.[5]

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[3] *See* Table VI.G1, Payroll Tax Contribution Rates for the OASDI and HI Programs, 2021 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds (published August 31, 2021).

[4] *See* Table V.C1, Intermediate projections, 2021 Annual Report. If the projected OASDI wage bases change in a subsequent year's Annual Report, SDG&E will update its 2024 payroll tax forecast in its Update Testimony filing to reflect the projected OASDI wage bases in the most recently released Annual Report, consistent with the Decision in SDG&E's 2019 GRC (the 2019 GRC Decision). *See* Decision (D.) 19-09-051, at 643, 646.

[5] SDG&E also has a small number of employees located in Nevada. Nevada's SUI rate is 0.6% for 2021 and 2022 and is not expected to change through 2024. The SUI wage base for Nevada is $33,400 for 2021 and $36,600 for 2022. The wage base is projected to increase to $40,100 in 2023

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

Payroll taxes are a function of taxable wages and applicable tax rates. The computation of the estimated payroll taxes begins with the 2021 taxable wages stratified into salary increments. The annual wage base in effect for the year for each type of payroll tax was applied to total wages so that wages up to, but not exceeding, the wage base cap were subject to the tax. Thus, wages up to the salary increment where the annual wage is closest to the wage base cap are subject to the tax. Wages above the wage base cap for any particular type of payroll tax were derived from multiplying the number of employees in each stratum above the cap by the wage base cap. The resulting taxable wages for each tax type were totaled and the applicable statutory tax rate was then applied to the total taxable wages. The Medicare portion of the FICA tax is computed without respect to a wage base since all wages are subject to that tax. A companywide composite tax rate was computed based on total forecasted payroll taxes using the above methodology divided by total forecasted wages. The composite payroll tax rate for each year was applied to labor dollars applicable to this Application to determine the employer's payroll tax expense.

C. **Summary of Estimated Payroll Taxes**

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

Table SDG&E-RR-1
Summary of Estimated Payroll Taxes
($ in Thousands)

	Line No.	*2021 Estimated*	*2022 Estimated*	*2023 Estimated*	*2024 Test Year*
Electric Distribution	1	9,459	10,530	11,477	13,585
Gas Distribution	2	4,877	6,036	6,520	6,960
Electric Generation	3	0	1,531	1,618	1,644

and $43,900 in 2024. The Nevada SUI has been included in SDG&E's payroll tax forecast for SDG&E's Nevada-based employees, but the impact is not material.

D. Results

The increase in payroll taxes from 2021 to 2024 reflects the impacts of staffing level changes presented by other witnesses in their direct testimonies, the impact of labor cost escalation on those changes, and the increase in the composite payroll tax rate resulting from the OASDI wage base increase as discussed above.

III. AD VALOREM TAXES

A. Introduction

The purpose of this section is to provide an estimate of SDG&E's ad valorem taxes that will be incurred during TY 2024, and to describe the methodology used to develop the estimate.

B. Discussion

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

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

The CEA, or the income approach to value, is designed to recognize the concept that the value of business property is closely related to its ability to generate income. The CEA indicator is used when the property being appraised is purchased in anticipation of receiving income (*i.e.*, rental property), and the actual future income stream can be reliably forecast, or a hypothetical

income stream can be estimated by comparison to other similar properties. The CEA is the preferred approach for the appraisal of properties when reliable sales data are not available, or the cost approach does not yield reliable results. The CEA is a secondary indicator of value for public utility property because the income of public utility property is limited by regulation, and comparison to the income stream from similar properties is limited.

SDG&E has filed its property statements with the SBE for the 2021 and 2022 lien dates. The property statements form the basis of the appraisals to set the value of SDG&E's property for the 2021-2022 and 2022-2023 fiscal years. The SBE reports the value of property subject to ad valorem tax annually on the "Notice of Unitary Appraised Value," which SDG&E has received for the 2021 lien date and expects to receive for the 2022 lien date by June 2022.

In correlating the value indicators calculated by the SBE from information contained in the property statement, the SBE applied a weighting of 75% to the HCLD indicator and 25% to the CEA indicator to derive the total appraised valuation of SDG&E's unitary property.[6] Added to the value of SDG&E's unitary property is the value of SDG&E's non-unitary property.[7] In estimating ad valorem taxes for ratemaking purposes, adjustments were made to exclude taxes resulting from: (a) the assessment of non-utility property since it is not included as an operating expense; and (b) Construction Work in Progress (CWIP), which is capitalized rather than directly charged to ad valorem tax expense. Also excluded is the value of electric transmission property—as such property is excluded from this proceeding.

The SBE has followed the same assessment methodology for several years. Consequently, SDG&E followed this methodology to estimate the assessed value for unitary property and the resulting ad valorem tax expense estimate for TY 2024.[8]

The tax rate used to estimate California ad valorem taxes is the basic statewide tax rate of 1% established under Proposition 13, plus an additional rate component of 0.7869%, which is a

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[6] 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.

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

[8] SDG&E's property tax forecast, based on this methodology, was approved by the CPUC in the 2019 GRC Decision. *See* the 2019 GRC Decision, at 644-645. Also *see* the 2019 GRC Decision, at 633 ("We find no issues regarding SoCalGas' methodology in arriving at its updated calculation which is based on the list of unitary property as determined by the SBE.").

composite rate derived from dividing taxes paid to local jurisdictions by the total assessed value of property in all voter-approved local assessment districts as allowed under Proposition 13. The escalation in the rates from 2021 to 2024 represents the average historical rate of increase in local tax rates over the most recent five-year period.

The estimated ad valorem taxes for SDG&E's Desert Star Energy Center, located in Nevada, are added to California ad valorem taxes as an "Other Adjustment" on the Electric Generation summary table, Table SDG&E-RR-2-3 below. The estimated ad valorem tax expense for TY 2024 is comprised of the second installment payment from fiscal year 2023-2024 plus the first installment payment for fiscal year 2024-2025.

SDG&E has used a five-year average of historical rate increases to forecast the escalation in ad valorem rates in several prior GRCs, and this methodology has been accepted in prior GRCs without exception. In SDG&E's 2019 GRC Decision, the Commission concluded that SDG&E's forecasting methodology was reasonable, and that its five-year historical average "is also the method that has been applied in SDG&E's recent GRCs and we find that no compelling reason was presented to support a change in methodology."[9] The Commission discussed and ultimately rejected The Utility Reform Network's (TURN) proposal to use a four-year historical average instead of a five-year average, stating that "[g]enerally, a longer period is used in order to normalize the fluctuations that may occur from year to year."[10]

C. Summary of Estimated Ad Valorem Tax Expenses

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

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[9] *Id.* at 644-645.

[10] *Id.* at 644.

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

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Line No.	*Description*	*2021 Recorded*	*2022 Estimated*	*2023 Estimated*	*2024 Test Year*
1	Taxable Plant in Service	9,422,419	10,078,251	10,765,403	11,426,158
2	Taxable Reserve for Depreciation	(3,599,549)	(3,822,935)	(4,105,625)	(4,401,652)
3	Taxable Net Plant	5,822,870	6,255,316	6,659,778	7,024,506
4	Taxable Reserve for Def. Inc. Tax	(577,483)	(554,081)	(528,568)	(508,084)
5	Adjustment for Income Approach	(12,589)	(13,683)	(14,715)	(15,639)
6	Assessed Value - Non-Unitary	11,512	12,513	13,456	14,302
7	Net Assessable Value	5,244,310	5,700,065	6,129,951	6,515,084
8	Ad Valorem Tax Rate	1.7869464%	1.8464608%	1.9059752%	1.9654897%
9	Ad Valorem Tax - Fiscal Year	93,713	105,249	116,835	128,053
10	Other Adjustments	42	42	42	42
	Fiscal Year				
11	Total Operating Ad Valorem Tax	93,755	105,291	116,877	128,095
12	Capitalized Ad Valorem Tax	(6,118)	(4,142)	(6,063)	(7,781)
13	Net Operating Ad Valorem Tax	87,637	101,149	110,814	120,314
	Calendar Year (Note 1)				
14	Total Operating Ad Valorem Tax	87,529	99,176	110,737	122,139
15	Capitalized Ad Valorem Tax	(6,825)	(3,536)	(4,055)	(7,378)
16	Net Operating Ad Valorem Tax	80,704	95,641	106,682	114,762

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8 **(Note 1) - Calendar year total operating ad valorem tax = ½ of the current fiscal**
9 **year total ad valorem tax plus ½ of the prior fiscal year total ad valorem tax.**
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Table SDG&E-RR-2-2
San Diego Gas & Electric Company
Summary of Estimated Ad Valorem Tax Expenses
Gas Distribution
($ in Thousands)

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Line No.	*Description*	*2021 Recorded*	*2022 Estimated*	*2023 Estimated*	*2024 Test Year*
1	Taxable Plant in Service	3,076,791	3,371,055	3,661,011	3,973,809
2	Taxable Reserve for Depreciation	(1,167,395)	(1,222,015)	(1,294,532)	(1,374,891)
3	Taxable Net Plant	1,909,396	2,149,040	2,366,479	2,598,918
4	Taxable Reserve for Def. Inc. Tax	(185,316)	(186,558)	(188,177)	(189,440)
5	Adjustment for Income Approach	(4,138)	(4,710)	(5,228)	(5,783)
6	Assessed Value - Non-Unitary	3,784	4,307	4,781	5,288
7	Net Assessable Value	1,723,726	1,962,079	2,177,855	2,408,984
8	Ad Valorem Tax Rate	1.7869464%	1.8464608%	1.9059752%	1.9654897%
9	Ad Valorem Tax - Fiscal Year	30,802	36,229	41,509	47,348
10	Other Adjustments	13	13	13	13
	Fiscal Year				
11	Total Operating Ad Valorem Tax	30,815	36,242	41,522	47,361
12	Capitalized Ad Valorem Tax	(2,237)	(2,232)	(3,839)	(5,049)
13	Net Operating Ad Valorem Tax	28,578	34,010	37,683	42,313
	Calendar Year (Note 1)				
14	Total Operating Ad Valorem Tax	28,426	33,416	38,769	44,329
15	Capitalized Ad Valorem Tax	(2,186)	(1,684)	(2,555)	(4,898)
16	Net Operating Ad Valorem Tax	26,240	31,732	36,214	39,431

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(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.

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

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Line No.	*Description*	*2021 Recorded*	*2022 Estimated*	*2023 Estimated*	*2024 Test Year*
1	Taxable Plant in Service	1,183,152	1,162,805	1,196,386	1,231,450
2	Taxable Reserve for Depreciation	(554,523)	(566,148)	(607,161)	(649,763)
3	Taxable Net Plant	628,629	596,657	589,225	581,687
4	Taxable Reserve for Def. Inc. Tax	(76,724)	(72,348)	(67,927)	(64,026)
5	Adjustment for Income Approach	(1,325)	(1,258)	(1,251)	(1,242)
6	Assessed Value - Non-Unitary	1,211	1,151	1,144	1,136
7	Net Assessable Value	551,792	524,202	521,191	517,554
8	Ad Valorem Tax Rate	1.7869464%	1.8464608%	1.9059752%	1.9654897%
9	Ad Valorem Tax - Fiscal Year	9,860	9,679	9,934	10,172
10	Other Adjustments	1,687	1,687	1,687	1,687
	Fiscal Year				
11	Total Operating Ad Valorem Tax	11,547	11,366	11,621	11,859
12	Capitalized Ad Valorem Tax	(703)	(367)	(453)	(522)
13	Net Operating Ad Valorem Tax	10,844	10,999	11,168	11,338
	Calendar Year (Note 1)				
14	Total Operating Ad Valorem Tax	10,924	11,413	11,449	11,696
15	Capitalized Ad Valorem Tax	(865)	(304)	(343)	(474)
16	Net Operating Ad Valorem Tax	10,059	11,109	11,107	11,222

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

D. Results

The changes from 2021 to TY 2024 are the result of changes in plant and depreciation balances presented by other witnesses in their direct testimonies, and the expected escalation in the tax rate for local assessments as discussed above.

IV. INCOME TAXES

A. Introduction

The purpose of this section is to provide an estimate of SDG&E's income tax expense for TY 2024, and to describe the assumptions and methodology used to calculate income tax expense. This section also presents and discusses the cumulative balances of the TMA as of December 31, 2021.

B. Discussion of Income Tax Expense

1. Impact of the Tax Cuts and Jobs Act

The TCJA was enacted on December 22, 2017.[11] The changes to federal tax law under the TCJA affected both individuals and corporations. The TCJA also included provisions specific to regulated utilities such as SDG&E. Most of the changes to federal tax law under the TCJA became effective beginning on January 1, 2018, although certain changes related to bonus depreciation became effective on September 28, 2017. The most significant change under the TCJA for corporations generally, and for regulated utility corporations specifically, was the lowering of the federal corporate tax rate from 35% to 21% beginning in 2018. The impact of the TCJA on SDG&E's income tax expense for TY 2024 is incorporated in the assumptions and methodology used to calculate income tax expense, which is discussed in remainder of this section.

2. Methodology

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

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

1 Consistent with CPUC D.84-05-036 issued in Order Instituting Investigation (OII) 24, the
2 income tax estimates contained in this section are based on SDG&E's stand-alone taxes, not on
3 an allocation of tax expense from Sempra Energy, the parent company of SDG&E.[12] Another
4 issue considered by the CPUC in OII 24 was whether expenses not borne by customers should be
5 included as income tax deductions in computing estimated TY income tax expense. The CPUC
6 stated that it had "consistently calculated income taxes for ratemaking purposes based on the cost
7 of service developed" from authorized expenses.[13]
8 The CPUC also found that if they were to include expenses not subject to rate recovery as
9 "a deduction in calculating taxable income, stockholders would be penalized by a reduction in
10 their net income equal to the full amount of the expenditures, because they would have no
11 offsetting tax deduction."[14] The Commission concluded that their method of excluding expenses
12 not borne by customers in the calculation of TY income tax expense is reasonable and should
13 continue.[15] As such, SDG&E follows this conclusion of law from OII 24 in this GRC
14 proceeding, as it has done in prior GRCs.
15 The estimates contained in this section were calculated using current federal and state tax
16 laws enacted through the date of this testimony. SDG&E has not attempted to forecast any
17 future changes in tax law in the income tax calculation. SDG&E has utilized current federal and
18 state statutory tax rates of 21% and 8.84%, respectively, in developing its estimate of federal and
19 state income tax expense.
20 As prescribed by the CPUC in D.84-05-036, SDG&E also used the statutory federal tax
21 rate of 21% and the statutory state tax rate of 8.84% in its development of the net-to-gross
22 multiplier used to gross-up tax expense to a revenue requirement.[16] State income tax expense
23 has been computed by reducing operating income by operating expenses, including property
24 taxes, payroll taxes, and making certain permanent and flow through tax adjustments for
25 differences in the book and state tax return treatment of items of income and expense (Schedule
26 M adjustments) as explained in more detail later in this section. Consistent with the CPUC

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

13 *Id*. at *15.

14 *Id*. at *16-18.

15 *Id*. at *62, Conclusion of Law (CoL) 2.

16 *Id.* at *62-63, CoL 9.

1 policy discussed in D.93848,[17] a flow through accounting methodology was utilized in
2 estimating state tax expense.[18]

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

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

14 Tax expense based on income has been reduced by the amortization of deferred
15 Investment Tax Credits (ITC) generated in prior years in accordance with SDG&E's prior
16 election under applicable law[21] to ratably flow through the ITC benefit as a reduction to
17 ratemaking tax expense at a rate not to exceed the book life of the property that generated the
18 ITC. This application conforms to the treatment of deferred ITC amortization mandated by
19 D.88-01-061,[22] and is the same treatment employed by SDG&E in prior rate cases.

20 SDG&E's federal income tax expense has been reduced by the amortization of remaining
21 excess deferred federal income taxes resulting from a reduction in the federal income tax rate
22 from a high of 41% prior to the Tax Reform Act of 1986 (TRA 86) to the current 21% under the
23 TCJA beginning in 2018, utilizing ARAM as required by Internal Revenue Service (IRS)

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[17] 1981 Cal. PUC LEXIS 1240; 7 CPUC 2d 332.

[18] Flow-through accounting treats temporary differences between recognition of expenses for book purposes and their tax return treatment as current adjustments to the revenue requirement.

[19] Normalized tax accounting follows the financial accounting treatment for items of income and expense in the revenue requirement calculation.

[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.

normalization rules and mandated by D.88-01-061.[23] Additionally, ARAM is the required method for amortizing plant-related excess accumulated deferred federal income tax (ADFIT) resulting from the tax rate reduction under the TCJA.[24] Only a small amount of excess ADFIT remains from the decrease in tax rate under TRA 86. The ARAM amount increased significantly beginning in 2018, due to the reduction in the federal corporate income tax rate from 35% to 21% under the TCJA. The ARAM rules and methodology required under the TCJA are discussed in more detail in Section IV.C.3 below.

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

3. Schedule M Items and Other Specific Tax Deductions

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

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

Fiscal Year/Calendar Year Property Tax Adjustment. An adjustment is made to add back book calendar-year property tax expense and deduct fiscal-year property tax expense as allowed by federal and state tax law. Consistent with CPUC policy,[25] this deduction is flowed through in the calculation of income tax expense.

23 *Id.* at *95-96.

24 TCJA Section 13001(d)(3)(B).

25 1981 Cal. PUC LEXIS 1240; 7 CPUC 2d 332.

1 Prior Year CCFT. Federal law allows a deduction for state income taxes paid. In
2 California, this is the CCFT deduction. For ratemaking purposes, D.89-11-058[26] specifies that
3 the allowable deduction is the prior years' CPUC-adopted CCFT, not the current year CCFT.
4 Since there is, as of yet, no CPUC-adopted CCFT, SDG&E has used the prior year's CCFT
5 estimate in calculating federal tax expense for TY 2024.
6 Internally-Developed Software. For financial accounting purposes, software
7 expenditures are capitalized and amortized to expense over various lives. For tax purposes, a
8 current-year deduction is allowed under IRC § 174 for internally-developed software
9 expenditures paid or incurred through 2021. For internally-developed software expenditures
10 paid or incurred beginning in 2022, the TCJA changed the tax treatment from a deduction of the
11 full amount in the year incurred to a five-year amortization period for such expenditures.[27] The
12 five-year amortization period begins with the mid-point of the taxable year in which such
13 expenditures are paid or incurred.[28] Accordingly, beginning in 2022, only a half-year of
14 amortization is allowed as a deduction in the year the internally-developed software expenditures
15 are paid or incurred.[29]
16 SDG&E has deducted internally developed software expenditures as a flow-through
17 deduction pursuant to D.84-05-036.[30] IRC § 167(f)[31] requires capitalization of un-modified, or
18 "canned" software. SDG&E applies normalized tax accounting treatment to expenditures for
19 canned software pursuant to D.84-05-036.
20 Federal Tax Depreciation. Federal tax depreciation on post-1980 vintage property is
21 governed by the normalization rules described above. Differences between book and tax
22 depreciation resulting from the different lives and methods used to compute book and tax
23 depreciation are normalized. Federal tax return depreciation on pre-1981 vintage property is

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

27 TCJA Sections 13206(a), (c)(3), and (e).

28 TCJA Section 13206(a)(2)(B).

29 The 2024 tax deduction for internally-developed software is a function of the forecasted spend on internally-developed software in TY 2024. Spend data is forecasted by capital witnesses in the rate base module of the Results of Operations Model, and the tax module pulls in the forecasted spend data from the rate base module.

30 1984 Cal. PUC LEXIS 1325.

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

flowed through as a deduction in the computation of federal taxable income, as is depreciation attributable to differences in the basis used to depreciate property for book and tax purposes.

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

Federal Cost of Removal. SDG&E follows the guidance in IRS Revenue Ruling 2000-7,[32] which provides a current tax deduction for actual costs to remove assets retired from service in the year that those costs are incurred. For book purposes, estimates of such costs are capitalized and depreciated over the life of the assets. Thus, there is a timing difference between tax and book. To be consistent with the treatment of property that is being depreciated under the Accelerated Cost Recovery System (ACRS) or the Modified Accelerated Cost Recovery System (MACRS) as described above, SDG&E normalizes the costs to remove those assets for federal tax purposes and flows through the federal removal costs only on pre-1981 vintage assets retired from service. This treatment is consistent with prior GRCs.

State Cost of Removal. California did not adopt the federal ACRS or MACRS depreciation systems, choosing instead to remain on the ADR system. Accordingly, SDG&E flows through removal costs for CCFT purposes irrespective of the vintage of the underlying assets per D.84-05-036.[33] This treatment is consistent with prior GRCs.

Repairs Deduction. The Schedule M adjustment for the repairs deduction represents the difference between expenditures that are permitted to be deducted as repairs for tax purposes and those same expenditures that are required to be capitalized for financial reporting purposes. SDG&E has flowed through the tax benefits associated with its projected repairs deduction to ratepayers for TY 2024 for both federal and California purposes in accordance with D.93848.

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[32] 2000-1 C.B. 712.

[33] 1984 Cal. PUC LEXIS 1325 at *59 (Finding of Fact 23).

Employee Transportation Benefits. Prior to the enactment of the TCJA, employers generally were allowed a deduction for the costs associated with providing transportation fringe benefits to its employees, such as parking and commuter rail costs, under IRC § 274. The TCJA amended IRC Section 274 effective January 1, 2018, to eliminate the deduction for expenses incurred in providing any transportation to employees, or any payment or reimbursement for transportation fringe benefits to employees, except as necessary to ensure the safety of the employee.[34] SDG&E continues to provide transportation fringe benefits to its employees. But since such costs are no longer deductible under the TCJA, SDG&E must add back these costs in computing taxable income.

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

C. Discussion of Deferred Taxes

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

All current law has been followed in the development of deferred federal income taxes. Accumulated deferred taxes for TY 2024 were developed on a monthly basis and prorated in accordance with the normalization requirements in Treas. Reg. § 1.167(l)-1(h)(6)(ii).[35]

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[34] TCJA Section 13304(c).

[35] 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.

1. **Bonus Depreciation**

a. **Pre-TCJA**

Prior to the enactment of the TCJA, the bonus depreciation rules allowed regulated utilities such as SDG&E to immediately expense a specified percentage of qualifying property placed into service in a particular year, rather than requiring the taxpayer to depreciate the full amount of the property over multiple years.[36]

For ratemaking purposes, bonus depreciation was subject to the tax normalization rules contained in IRC § 168 and Treasury Regulations under former IRC § 167. The ratemaking effect of bonus depreciation was to increase federal tax return depreciation above the regular tax depreciation provided by the federal MACRS depreciation system for a particular year. The extra bonus tax depreciation created additional deferred taxes equal to the extra bonus depreciation multiplied by the federal income tax rate. The additional deferred taxes created by bonus depreciation were reflected in the accumulated deferred tax balances for purposes of calculating rate base.

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

The bonus depreciation rules under the TCJA supersede the prior bonus depreciation rules for qualified property acquired pursuant to a written binding contract and placed in service after September 27, 2017 (or for self-constructed property for which construction began after such date).[37] For such property, the TCJA generally increased the bonus depreciation allowance to 100 percent through the end of 2022.[38] The TCJA also specified, however, that bonus depreciation is not available for assets acquired or self-constructed in the trade or business of the furnishing or sale of:

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

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36 Former IRC § 168(k), prior to amendment by the TCJA.

37 TCJA Section 13201(h)(1).

38 TCJA Section 13201(a)(2).

political subdivision thereof, or by the governing or ratemaking body of an electric cooperative.[39]

Accordingly, for property acquired (or self-constructed) and placed in service after September 27, 2017, the TCJA generally eliminated the bonus depreciation deduction for regulated utilities such as SDG&E. The TCJA included a bonus depreciation transition rule for property that was acquired (or for which self-construction began) before September 27, 2017.[40] But it was unclear from the statute how that transition rule applied to regulated utilities.

On September 13, 2019, and on November 5, 2020, the IRS and the United States Treasury Department (Treasury) issued final regulations clarifying the TCJA's changes to the bonus depreciation rules. The final regulations clarified that: (1) for property purchased or self-constructed by regulated utilities after September 27, 2017 and placed in service on or before December 31, 2017, such property was eligible for 100% bonus depreciation under the general rule of the TCJA;[41] and (2) for property acquired (or for which self-construction began) by regulated utilities prior to September 27, 2017, and placed into service in 2018 or later, the pre-TCJA rules and deduction percentages applied.[42] Under the pre-TCJA rules, the specified percentage of allowable bonus depreciation was 40% and 30% for property placed in service in 2018 and 2019, respectively.[43] Unless the property qualified as Long Production Period Property (LPPP),[44] there was no bonus depreciation allowed for property placed in service in 2020 or later. For LPPP, the pre-TCJA rules specified a bonus depreciation percentage of 50%, 40%, and 30% for property placed in service in 2018, 2019, and 2020, respectively.[45] Bonus depreciation was not allowed for LPPP placed in service in 2021 or later.

Accordingly, under both the general rule and the transition rules of the TCJA, no bonus depreciation is allowed for regulated utilities for property placed in service in 2021 or later.

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[39] TCJA Sections 13201(d)(9)(A) and 13301(a).

[40] TCJA Section 13201(a)(8).

[41] Treas. Reg. § 1.168(k)-2(b)(2)(ii)(F) and (f)(3).

[42] Treas. Reg. § 1.168(k)-2(c)(9)(i), Example 1.

[43] IRC § 168(k)(8).

[44] To qualify as LPPP, the property must have a recovery period of at least 10 years, an estimated production period exceeding one year, and a cost exceeding $1 million. IRC § 168(k)(2)(B)(i).

[45] IRC § 168(k)(8).

Therefore, no bonus depreciation deductions are reflected in the forecasts for any of the years included in SDG&E's 2024 GRC. However, the residual impact of bonus depreciation taken on qualified property placed in service in prior periods, when bonus depreciation was allowed, is reflected in the accumulated deferred income tax balances for 2021-2024.

2. Contributions-in-Aid-of-Construction

Contributions-in-aid-of-construction (CIAC) are non-refundable contributions collected from utility customers in the form of money – or its equivalent – toward the construction of plant, such as customer-requested relocations. CIAC became taxable under the TRA 86. The CPUC proposed the Maryland Method or Method 5 as acceptable alternatives for the ratemaking treatment of CIAC in D.87-09-026.[46] SDG&E elected the Maryland Method to account for the tax impacts of CIAC and the related income tax component of CIAC (ITCC) as required by the TRA 86. In accordance with D.87-09-026, SDG&E has thus not reflected any impact on rate base for the tax paid on CIAC income and the related ITCC received subsequent to February 10, 1987—the date that CIAC became taxable under the TRA 86. Under the Maryland Method, the utility shareholders bear the impact of any shortfall between the tax liability and the tax gross-up ITCC collected from the contributor. The shareholders recover the shortfall through the tax depreciation benefits on the constructed property. Accordingly, there is no impact on rate base.

3. Excess Deferred Taxes Related to the TCJA

SDG&E recomputed its ADFIT balances as of January 1, 2018 to reflect the reduction in the federal corporate income tax rate from 35% to 21% under the TCJA. The difference in the ADFIT balance under the old tax rate versus under the new tax rate represents the excess deferred tax reserve created by the TCJA. The TCJA defines the "excess tax reserve" as "(i) the reserve for deferred taxes (as described in section 168(i)(9)(A)(ii) of the Internal Revenue Code of 1986) as of the day before the corporate rate reductions . . . made by this section take effect, over (ii) the amount which would be the balance in such reserve if the amount of such reserve were determined by assuming that the corporate rate reductions provided in this Act were in effect for all prior periods."[47]

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[46] 1987 Cal. PUC LEXIS 195; 25 CPUC 2d 299.

[47] 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.

1 **a. Protected Assets**

2 SDG&E has begun the process of returning the excess ADFIT to its customers. But in
3 doing so, SDG&E must adhere to the timing rules and other requirements under the TCJA.
4 Failure to follow these rules and procedures will result in a normalization violation.[48] The TCJA
5 specifies that utilities may not return the excess ADFIT associated with utility plant assets
6 (excess plant-based ADFIT) more rapidly than ratably over the life of the underlying assets.[49]
7 Specifically, utilities are generally not permitted, in computing costs of service for ratemaking
8 purposes, to refund excess plant-based ADFIT more rapidly or greater than the reductions
9 permitted by the ARAM approach, which requires amortization of the excess tax reserve over the
10 remaining regulatory lives of the property that gave rise to the ADFIT.[50] The TCJA defines
11 ARAM as follows:

12 The average rate assumption method is the method under which the excess
13 in the reserve for deferred taxes is reduced over the remaining lives of the
14 property as used in its regulated books of account which gave rise to the
15 reserve for deferred taxes. Under such method, during the time period in
16 which the timing differences for the property reverse, the amount of the
17 adjustment to the reserve for the deferred taxes is calculated by
18 multiplying – (i) the ratio of the aggregate deferred taxes for the property
19 to the aggregate timing differences for the property as of the beginning of
20 the period in question, by (ii) the amount of the timing differences which
21 reverse during such period.[51]

22 The requirement to use ARAM applies only to excess deferred taxes on plant-based
23 assets that are subject to the IRS normalization rules (also known as "protected" assets). If a
24 utility's books and records do not contain the vintage data necessary to apply ARAM, the TCJA
25 allows the utility to use an alternative method that amortizes the excess plant-based ADFIT
26 ratably over the remaining average life or composite rate used to compute depreciation for
27 regulatory purposes.[52]

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48 TCJA Section 13001(d)(4).

49 TCJA Section 13001(d)(1).

50 TCJA Section 13001(d)(3)(B).

51 TCJA Section 13001(d)(3)(B).

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

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

5 Among the TCJA impacts considered by the CPUC in the 2019 GRC Decision was the
6 proper computation of ARAM— specifically, when computing the ARAM (as per TCJA section
7 13001(d)(3)(B)), whether the cost of removal should be included or excluded from book
8 depreciation in the ARAM calculation.[53] Ultimately, the CPUC and SDG&E disagreed on the
9 inclusion of cost of removal in the ARAM calculation. SDG&E's position was that, to be
10 consistent with the normalization rules, cost of removal should be excluded from the ARAM
11 computation. However, the CPUC concluded that unless otherwise directed by the IRS, SDG&E
12 should not exclude cost of removal from the ARAM computation.[54] Specifically, the decision
13 includes the following analysis and conclusion from the CPUC:[55]

> 14 The IRS does not provide sufficient ARAM guidance regarding whether
> 15 [SDG&E's] adjustment concerning removal costs is appropriate, but we find that
> 16 excluding costs of removal has the effect of delaying the refund to ratepayers as
> 17 compared to not applying this adjustment. This is because the ARAM calculation
> 18 compares accelerated depreciation to book depreciation and when there is reduced
> 19 book depreciation (due to excluding cost of removal), there is less total ARAM
> 20 return of excess ADIT. Absent clear guidance from the IRS, we find it more
> 21 reasonable to disallow this adjustment as we do not believe that this violates the
> 22 IRS normalization rules concerning return of excess ADIT in the TCJA and so as
> 23 not to delay the refund to ratepayers.

24 Accordingly, the CPUC's methodology results in a larger amount of book depreciation in
25 all years (and a more rapid return of excess ADFIT to customers).

26 Notwithstanding the CPUC's determination, the Commission found it "prudent and
27 reasonable to allow [SDG&E] to track the revenue requirement difference between including and
28 excluding cost of removal from the ARAM calculation," and to allow SDG&E to seek recovery

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[53] "Cost of removal" is the cost of demolishing, dismantling, tearing down, or otherwise removing electric or gas plant, including incidental transportation and handling costs.

[54] The Commission did not separately discuss SDG&E's income tax issues in the 2019 GRC Decision. Rather, the Commission stated: "We make the same findings and conclusions with regards to SDG&E's Income Taxes as we did in the SoCalGas section," and then provided a cross reference to the SoCalGas discussion of income tax issues. *See* D.19-09-051, at 645-646.

[55] D.19-09-051, at 637-638.

of such difference in the event the IRS issues a ruling or releases further guidance indicating that cost of removal should be excluded from the ARAM calculation.[56] In such case, the CPUC stated that SDG&E "should seek recovery of any difference in costs by filing a Tier 2 advice letter seeking appropriate adjustment to its revenue requirement."[57]

On October 8, 2021, SDG&E filed a Private Letter Ruling request with the IRS National Office, requesting clarification on the ARAM calculation methodology. SDG&E requested the following rulings from the IRS in its request:

1. Whether the CPUC's method of including book cost of removal in the ARAM calculation for the return of excess deferred taxes to ratepayers is inconsistent with the normalization rules.

2. Whether the method proposed by SDG&E of excluding book cost of removal in the ARAM calculation for the return of excess deferred taxes to ratepayers is consistent with the normalization rules.

3. Whether SDG&E's use of the method proposed by the CPUC, as required by the 2019 GRC Decision, will not be a violation of the normalization rules, provided the Commission (i) approves the method proposed by SDG&E (or otherwise required by the Service) and (ii) allows SDG&E to recover any difference in the rates charged to customers under the Commission's proposed method and SDG&E's method under the procedures for such recovery as set forth in the 2019 GRC Decision.

On April 28, 2022, the IRS issued its Private Letter Ruling to SDG&E, reaching a different conclusion than D.19-09-051.[58] Specifically, the IRS concluded that:

1. The CPUC's method of including book cost of removal in the ARAM calculation for the return of excess deferred taxes to ratepayers is inconsistent with the normalization rules.

2. The method proposed by SDG&E of excluding book cost of removal in the ARAM calculation for the return of excess deferred taxes to ratepayers is consistent with the normalization rules.

3. SDG&E's use of the method proposed by the CPUC, as reflected in the 2019 GRC Decision, is not a violation of the normalization rules, provided that the Commission: (i) approves the method proposed by SDG&E (or otherwise required by the Service); and (ii) allows SDG&E to recover any difference in the

[56] D.19-09-051, at 638.

[57] D.19-09-051, at 638.

[58] PLR-122706-21.

rates charged to customers under the Commission's proposed method and SDG&E's method.

Accordingly, the ARAM forecasts included in this 2024 GRC have excluded book cost of removal from the ARAM calculation, consistent with the IRS's conclusions. In addition, as noted, because SDG&E's Private Letter Ruling makes findings are different than those adopted in D.19-09-051, SDG&E will follow the process outlined in D.19-09-051 and file a Tier 2 advice letter seeking appropriate adjustment to its revenue requirement.[59]

b. Unprotected Assets

As stated above, the requirement to use ARAM applies only to excess ADFIT on plant-based assets that are subject to the IRS normalization rules (also known as "protected" assets). In contrast, "unprotected" assets are not subject to the IRS normalization rules. There are thus no IRS restrictions regarding how excess ADFIT on unprotected assets are returned to ratepayers. In the 2019 GRC Decision, the Commission adopted TURN's proposal for returning excess ADFIT on unprotected assets to ratepayers.[60] TURN had proposed to amortize and return to ratepayers the excess ADFIT from SDG&E's unprotected assets over a six-year period, with a the exception of the unprotected ADFIT related to the cost or removal tax deduction.[61] Cost of removal is not allowed as a deduction for tax purposes until the property is removed, which generally occurs at the end of the property's useful life.

In contrast, cost of removal is expensed ratably over the property's useful life for book purposes. This timing difference between book and tax creates a deferred tax asset, which causes rates to increase in the future as the excess ADFIT related to cost of removal is reversed over time. Because of the unique aspects of the cost of removal tax deduction as compared to

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[59] The IRS's conclusions in SDG&E's Private Letter Ruling are consistent with the IRS's conclusions in the recently issued Private Letter Rulings for Southern California Edison Company (SCE) and Pacific Gas and Electric Company (PG&E) on the same issue. In both cases, the IRS ruled that the Commission's method of including book cost of removal in the ARAM calculation is inconsistent with the normalization rules, while the utility's proposed method of excluding book cost of removal from the ARAM calculation is consistent with the normalization rules. *See* PLR 202141001 (for SCE), published on Oct. 15, 2021; PLR 202211004 (for PG&E), published on March 18, 2022. SCE and PG&E have filed their respective Tier 2 advice letters to recover the difference in rates caused by excluding book cost of removal from the ARAM calculation, as directed by the Commission.

[60] D.19-09-051, at 638.

[61] May 14, 2018, Prepared Testimony of William Perea Marcus, Report on the Various Results of Operations Issues in Southern California Gas Company's and San Diego Gas and Electric Company's 2019 Test Year General Rate Cases, Ex. TURN-03 (Ex. TURN-03 (Marcus)), at 83-84.

SDG&E's other unprotected assets, TURN proposed to "apply the same ARAM-based treatment" to the excess ADFIT related to the cost of removal tax deduction "as for protected assets," instead of the six-year amortization period TURN had proposed for SDG&E's other unprotected assets.[62]

SDG&E has continued to follow the Commission's instructions from the 2019 GRC Decision regarding the treatment of unprotected excess ADFIT, and such treatment is reflected in the 2024 GRC forecasts. SDG&E began amortizing the unprotected excess ADFIT over a six-year period (except for the excess ADFIT related to cost of removal) beginning in 2018. Accordingly, these unprotected excess ADFIT amounts are fully amortized by the end of 2023. Also, consistent with the 2019 GRC Decision, SDG&E has continued to apply ARAM-based treatment to amortize the excess ADFIT associated with the cost of removal tax deduction in its 2024 GRC forecasts.

D. Summary Tables

The following summary tables reflect the federal and state income taxes applicable to this filing. The "Electric Distribution" tables, Table SDG&E-RR-3-1 and Table SDG&E-RR-4-1, include electric distribution and electric generation for 2021.

[62] Ex. TURN-03 (Marcus), at 83.

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

Line No.	*Description*	*2021 Recorded*	*2022 Estimated*	*2023 Estimated*	*2024 Test Year*
1	Total Operating Revenue	1,721,438	1,726,296	1,824,592	2,108,930
2	O&M Expenses	(705,247)	(702,640)	(733,010)	(884,881)
3	Taxes Other than Income Taxes	(100,222)	(106,170)	(118,159)	(128,347)
4	Book Income Before Depr. & Income Taxes	915,968	917,486	973,423	1,095,702
5	State Tax Adjustments	(730,205)	(673,513)	(728,614)	(752,932)
6	Taxable Income	185,763	243,973	244,809	342,769
7	CCFT Rate	8.84%	8.84%	8.84%	8.84%
8	**California Corporate Franchise Tax**	16,421	21,567	21,641	30,301
9	Book Income Before Depr. & Income Taxes (Line 4, above)	915,968	917,486	973,423	1,095,702
10	Federal Tax Adjustments	(732,101)	(578,938)	(645,515)	(700,040)
11	Taxable Income	183,867	338,548	327,908	395,662
12	Federal Income Tax Rate	21%	21%	21%	21%
13	Federal Income Tax Before Credits	38,612	71,095	68,861	83,089
14	Investment Tax Credit Amortization	(726)	(726)	(726)	(726)
15	Amortization of Excess Deferred Taxes	(8,515)	(8,190)	(8,526)	(5,576)
16	Other	(1,819)	(1,441)	(1,442)	(1,442)
17	**Total Federal Income Tax**	27,553	60,738	58,167	75,345

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

Line No.	*Description*	*2021 Recorded*	*2022 Estimated*	*2023 Estimated*	*2024 Test Year*
1	Total Operating Revenue	489,255	556,318	602,438	663,594
2	O&M Expenses	(202,223)	(225,786)	(236,634)	(255,787)
3	Taxes Other than Income Taxes	(31,117)	(37,768)	(42,735)	(46,391)
4	Book Income Before Depr. & Income Taxes	255,915	292,764	323,069	361,415
5	State Tax Adjustments	(187,409)	(211,208)	(235,646)	(259,813)
6	Taxable Income	68,506	81,556	87,424	101,602
7	CCFT Rate	8.84%	8.84%	8.84%	8.84%
8	**California Corporate Franchise Tax**	6,056	7,210	7,728	8,982
9	Book Income Before Depr. & Income Taxes (Line 4, above)	255,915	292,764	323,069	361,415
10	Federal Tax Adjustments	(161,184)	(163,656)	(188,517)	(226,316)
11	Taxable Income	94,731	129,108	134,552	135,099
12	Federal Income Tax Rate	21%	21%	21%	21%
13	Federal Income Tax Before Credits	19,894	27,113	28,256	28,371
14	Investment Tax Credit Amortization	-	-	-	-
15	Amortization of Excess Deferred Taxes	(1,448)	(1,433)	(1,522)	(1,290)
16	Other	(5)	(1)	(1)	(1)
17	**Total Federal Income Tax**	18,441	25,679	26,733	27,080

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

Line No.	*Description*	*2021 Recorded*	*2022 Estimated*	*2023 Estimated*	*2024 Test Year*
1	Total Operating Revenue	-	220,235	226,242	234,585
2	O&M Expenses	-	(87,480)	(90,353)	(93,030)
3	Taxes Other than Income Taxes	-	(12,640)	(12,725)	(12,866)
4	Book Income Before Depr. & Income Taxes	-	120,115	123,164	128,688
5	State Tax Adjustments	-	(50,750)	(52,232)	(54,430)
6	Taxable Income	-	69,365	70,932	74,259
7	CCFT Rate	8.84%	8.84%	8.84%	8.84%
8	**California Corporate Franchise Tax**	-	6,132	6,270	6,564
9	Book Income Before Depr. & Income Taxes (Line 4, above)	-	120,115	123,164	128,688
10	Federal Tax Adjustments	-	(71,014)	(79,134)	(80,982)
11	Taxable Income	-	49,102	44,030	47,707
12	Federal Income Tax Rate	21%	21%	21%	21%
13	Federal Income Tax Before Credits	-	10,311	9,246	10,018
14	Investment Tax Credit Amortization	-	-	-	-
15	Amortization of Excess Deferred Taxes	-	-	-	-
16	Other	-	-	-	-
17	**Total Federal Income Tax**	-	10,311	9,246	10,018

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

Line No.	*Description*	*2021 Recorded*	*2022 Estimated*	*2023 Estimated*	*2024 Test Year*
	Federal Tax Adjustments:				
1	Tax Depreciation	(352,969)	(321,501)	(339,279)	(362,419)
2	Fixed Charges – Operating	(109,425)	(104,833)	(110,561)	(124,923)
3	Repairs	(147,849)	(112,386)	(131,247)	(126,180)
4	Software Development	(84,932)	(9,061)	(29,502)	(50,097)
5	Cost of Removal	(9,428)	(10,452)	(10,452)	(10,452)
6	Ad Valorem Tax - Fiscal/Calendar	(7,719)	(5,509)	(4,132)	(5,552)
7	Disallowed Transportation Fringe Benefits	601	1,221	1,221	1,221
8	Credit Addback & Other	37	4	4	4
9	Prior Year Calif. Corp. Franchise Tax	(20,417)	(16,421)	(21,567)	(21,641)
10	Total Federal Tax Adj. (Deduction)	(732,101)	(578,938)	(645,515)	(700,040)
	State Tax Adjustments:				
11	Tax Depreciation	(310,144)	(290,484)	(299,178)	(334,397)
12	Fixed Charges – Operating	(109,212)	(104,634)	(110,377)	(124,755)
13	Repairs	(147,849)	(112,386)	(131,247)	(126,180)
14	Software Development	(84,932)	(90,614)	(113,793)	(92,161)
15	Cost of Removal	(70,349)	(69,887)	(69,887)	(69,887)
16	Ad Valorem Tax - Fiscal/Calendar	(7,719)	(5,509)	(4,132)	(5,552)
17	Credit Addback & Other	-	-	-	-
18	Total State Tax Adj. (Deduction)	(730,205)	(673,513)	(728,614)	(752,932)

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

Line No.	*Description*	*2021 Recorded*	*2022 Estimated*	*2023 Estimated*	*2024 Test Year*
	Federal Tax Adjustments:				
1	Tax Depreciation	(84,904)	(94,370)	(103,165)	(119,017)
2	Fixed Charges – Operating	(34,051)	(38,347)	(42,202)	(47,183)
3	Repairs	(28,517)	(18,291)	(24,122)	(32,843)
4	Software Development	(12,180)	(2,723)	(8,759)	(15,072)
5	Cost of Removal	(1,523)	(1,757)	(1,757)	(1,757)
6	Ad Valorem Tax - Fiscal/Calendar	(2,338)	(2,278)	(1,469)	(2,882)
7	Disallowed Transportation Fringe Benefits	86	166	166	166
8	Credit Addback & Other	5	1	1	1
9	Prior Year Calif. Corp. Franchise Tax	2,237	(6,056)	(7,210)	(7,728)
10	Total Federal Tax Adj. (Deduction)	(161,184)	(163,656)	(188,517)	(226,316)
	State Tax Adjustments:				
11	Tax Depreciation	(98,958)	(113,309)	(122,976)	(135,157)
12	Fixed Charges – Operating	(34,051)	(38,347)	(42,202)	(47,183)
13	Repairs	(28,517)	(18,291)	(24,122)	(32,843)
14	Software Development	(12,180)	(27,233)	(33,127)	(29,998)
15	Cost of Removal	(11,365)	(11,750)	(11,750)	(11,750)
16	Ad Valorem Tax - Fiscal/Calendar	(2,338)	(2,278)	(1,469)	(2,882)
17	Credit Addback & Other	-	-	-	-
18	Total State Tax Adj. (Deduction)	(187,409)	(211,208)	(235,646)	(259,813)

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

Line No.	*Description*	*2021 Recorded*	*2022 Estimated*	*2023 Estimated*	*2024 Test Year*
	Federal Tax Adjustments:				
1	Tax Depreciation	-	(60,001)	(61,677)	(62,800)
2	Fixed Charges – Operating	-	(11,122)	(11,263)	(11,795)
3	Repairs	-	-	-	-
4	Software Development	-	-	-	-
5	Cost of Removal	-	-	-	-
6	Ad Valorem Tax - Fiscal/Calendar	-	110	(62)	(116)
7	Disallowed Transportation Fringe Benefits	-	-	-	-
8	Credit Addback & Other	-	-	-	-
9	Prior Year Calif. Corp. Franchise Tax	-	-	(6,132)	(6,270)
10	Total Federal Tax Adj. (Deduction)	-	(71,014)	(79,134)	(80,982)
	State Tax Adjustments:				
11	Tax Depreciation	-	(39,738)	(40,907)	(42,519)
12	Fixed Charges – Operating	-	(11,122)	(11,263)	(11,795)
13	Repairs	-	-	-	-
14	Software Development	-	-	-	-
15	Cost of Removal	-	-	-	-
16	Ad Valorem Tax - Fiscal/Calendar	-	110	(62)	(116)
17	Credit Addback & Other	-	-	-	-
18	Total State Tax Adj. (Deduction)	-	(50,750)	(52,232)	(54,430)

2 **E. Results**

3 The overall increase in federal and state income tax expense from 2021 to TY 2024 is
4 primarily a function of increasing book income before taxes resulting from the return on an
5 increasing rate base (see the testimony of Steven P. Dais, Exhibit SDG&E-35, for a discussion of
6 rate base). Federal and state tax adjustments are also growing annually which, in turn, partially
7 offsets the growth in book income before taxes from 2021 to TY 2024.

F. Tax Memorandum Account

1. Background

In SDG&E's 2016 GRC Decision,[63] the Commission instructed SDG&E to establish a TMA for the 2016 GRC cycle (January 1, 2016 – December 31, 2018).[64] As stated by the Commission in that decision, the purpose of the TMA "is to increase the transparency of the utilities' incurred and forecasted income tax expenses to the Commission, so that the Commission can more closely examine the revenue impacts caused by the utilities' implementation of various tax laws, tax policies, tax accounting changes, or tax procedure changes."[65] The TMA "shall remain open and the balance in the account shall be reviewed in every subsequent GRC proceeding until a Commission decision closes the account."[66]

In the 2019 GRC Decision, the Commission concluded that the TMA should be maintained for the 2019 GRC cycle.[67] The Commission also clarified that "the TMA is not meant as a true-up mechanism between actual and forecast tax expenses that are not caused by changes in tax law, tax accounting methods, tax procedures, and tax policy," and that the TMA "only tracks differences arising from changes in tax law, tax accounting changes, tax policy changes, or procedural changes."[68] The Commission concluded that "SoCalGas and SDG&E may file separate Tier 1 advice letters within 45 days from the effective date of this decision to implement any necessary changes to their respective TMAs consistent with this decision."[69]

Pursuant to the Commission's directive, SDG&E filed Advice Letter 3462-E/2820-G on November 12, 2019 to continue the TMA for the 2019 GRC cycle, and to reflect the Commission's clarifications regarding the scope and purpose of the TMA as provided in the 2019 GRC decision. The Commission approved the Advice Letter, without modification, on April 10, 2020.

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[63] D.16-06-054.

[64] *Id.* at Ordering Paragraph 4.

[65] *Id.* at 196.

[66] *Id*.

[67] D.19-09-051, at 639.

[68] D.19-09-051, at 639, 648.

[69] D.19-09-051, Conclusion of Law 99, at 773.

As discussed in Advice Letter 3462-E/2820-G, the TMA is a two-way tracking account, not posted to SDG&E's general ledger, that tracks tax-related items that are the result of changes in tax law, tax accounting, tax policy, or tax procedure. Specifically, the TMA separately tracks the revenue requirement impact of the differences between tax expenses authorized in the GRC and tax expenses incurred resulting from: (1) mandatory tax law changes, tax accounting changes, tax procedural changes, and tax policy changes; (2) elective tax law changes, tax accounting changes, tax procedural changes, and tax policy changes; (3) other net revenue changes caused by tax law changes, tax accounting changes, tax procedural changes, and tax policy changes; (4) the completion of audits by federal and state taxing authorities; and (5) the implementation of any IRS private letter ruling regarding compliance with IRS normalization regulations.

In addition, in the 2019 GRC Decision, the Commission specifically authorized SDG&E to track in its TMA the following items, which are included within the categories listed above: (1) revenue requirement differences between including and excluding cost of removal from the ARAM calculation in the event that the IRS issues a ruling or releases further guidance that is inconsistent with D.19-09-051;[70] (2) revenue requirement differences between applying ARAM to excess deferred taxes on unprotected assets and applying a six-year amortization period to excess deferred taxes on such assets to "ensure that the process set forth in this decision does not contravene the IRS's normalization rules;"[71] and (3) any significant changes as a result of further guidelines provided by the IRS that necessitates an adjustment to the revenue requirements.[72]

Consistent with D.19-09-051, SDG&E is tracking and will continue to track the items in the TMA in accordance with the provisions of Advice Letter 3462-E/2820-G until such time that the Commission closes the account.

2. Cumulative TMA Balances as of December 31, 2021

Based on the foregoing and in accordance with D.19-09-051, SDG&E presents the cumulative TMA balances as of December 31, 2021. A schedule that shows the cumulative TMA balances (TMA Schedule) is attached as Appendix B. Consistent with the CPUC's

[70] D.19-09-051, at 638.

[71] D.19-09-051, at 639.

[72] D.19-09-051, at 639.

1 clarifications regarding the purpose and scope of the TMA as articulated in D.19-09-051, the
2 TMA Schedule reflects the impact of differences between authorized and incurred amounts
3 related to changes in tax law, tax accounting, tax procedure, or tax policy, holding all other
4 authorized items constant. Because the tax impacts have not been incurred until they are
5 reflected in a filed tax return, as a general rule, only items and amounts that have been reported
6 on an originally filed or amended tax return are included in the TMA Schedule. However, to
7 provide additional transparency to the CPUC, SDG&E is also including in its TMA Schedule:
8 (1) tax items and amounts that SDG&E intends to include in amended returns to be filed after the
9 2024 TY GRC Application is filed; and (2) 2021 items and amounts that SDG&E intends to
10 include in its yet-to-be-filed 2021 federal and California income tax returns.[73]

11 If the change in tax expense would decrease revenue, the amount is shown as a credit in
12 the TMA Schedule. If the change in tax expense would increase revenue, the amount is shown
13 as a debit in the TMA Schedule. As of December 31, 2021, the total, cumulative revenue impact
14 of the tracked items shown in the TMA Schedule is a debit balance of $28.646 million.[74] Each
15 line item in the TMA Schedule is discussed in turn, below.

16 **a. Mandatory Changes in Tax Law, Tax Accounting, Tax**
17 **Procedures, or Tax Policy**

18 Bonus Depreciation

19 As discussed earlier in the Income Taxes section of my testimony, on September 13,
20 2019, and on November 5, 2020, the IRS and Treasury issued final regulations clarifying the

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[73] SDG&E anticipates filing its 2021 federal and California income tax returns shortly before the extended due dates for these returns, which are October 15, 2022 and November 15, 2022, respectively.

[74] In SDG&E's 2016 GRC Decision, the Commission directed SDG&E to notify the Commission of any tax-related changes that may potentially increase or decrease revenues by $3 million or more. D.16-06-054, at 196-197. As discussed earlier in my testimony, in the 2019 GRC Decision, the Commission allowed SDG&E to track the revenue requirement difference in its TMA between including and excluding cost of removal from the ARAM calculation. In addition, SDG&E provided a draft of its Private Letter Ruling request on this issue to the Commission's Energy Division before filing the request with the IRS. Accordingly, the Commission is aware of this issue, for which the tracked difference is reflected in the TMA Schedule. As of the filing date of the 2024 GRC Application, there are no other incurred items being tracked in the TMA Schedule that exceed the $3 million threshold. However, after SDG&E files its 2021 tax returns and files amended returns for prior years, SDG&E anticipates that other items being tracked in the TMA could impact revenues by more than $3 million. These items, and their anticipated future revenue impact, are identified and reflected in the TMA Schedule attached hereto as Appendix B.

1 TCJA's changes to the bonus depreciation rules. The final regulations clarified that: (1) for
2 property purchased or self-constructed by regulated utilities after September 27, 2017 and placed
3 in service on or before December 31, 2017, such property was eligible for 100% bonus
4 depreciation under the general rule of the TCJA;[75] and (2) for property acquired (or for which
5 self-construction began) by regulated utilities prior to September 27, 2017, and placed into
6 service in 2018 or later, the pre-TCJA rules and deduction percentages applied.[76] Under the pre-
7 TCJA rules, the specified percentage of allowable bonus depreciation was 40% and 30% for
8 property placed in service in 2018 and 2019, respectively.[77] Unless the property qualified as
9 LPPP,[78] there was no bonus depreciation allowed for property placed in service in 2020 or later.
10 For LPPP, the pre-TCJA rules specified a bonus depreciation percentage of 50%, 40%, and 30%
11 for property placed in service in 2018, 2019, and 2020, respectively.[79] Bonus depreciation was
12 not allowed for LPPP placed in service in 2021 or later.

13 As a result of these clarifications, SDG&E qualifies for additional bonus depreciation in
14 the 2017 – 2019 tax years.[80] This additional bonus depreciation will increase ADFIT, which in
15 turn will reduce rate base. The additional bonus depreciation for 2017 – 2019 will continue to
16 impact rate base in subsequent years until the ADFIT related to the additional bonus depreciation
17 fully reverses. The revenue impact of the additional bonus depreciation is reflected in the TMA
18 Schedule.

19 Employee Transportation Benefits

20 Prior to the enactment of the TCJA, employers generally were allowed a deduction for
21 the costs associated with providing transportation fringe benefits to its employees, such as
22 parking and commuter rail costs, under IRC § 274. The TCJA amended IRC § 274 effective
23 January 1, 2018 to eliminate the deduction for expenses incurred in providing any transportation

[75] Treas. Reg. § 1.168(k)-2(b)(2)(ii)(F) and (f)(3).

[76] Treas. Reg. § 1.168(k)-2(c)(9)(i), Example 1.

[77] IRC § 168(k)(8).

[78] To qualify as LPPP, the property must have a recovery period of at least 10 years, an estimated production period exceeding one year, and a cost exceeding $1 million. IRC § 168(k)(2)(B)(i).

[79] IRC § 168(k)(8).

[80] The additional bonus depreciation for 2018 has yet to be included on a filed tax return, but SDG&E intends to include it on an amended return for 2018.

to employees, or any payment or reimbursement for transportation fringe benefits to employees, except as necessary to ensure the safety of the employee.[81]

Initially, SDG&E did not believe this tax law change would impact its tax deduction related to employee parking, because SDG&E's costs of maintaining and operating its employee parking lots were incurred for the convenience of the company, and SDG&E's parking lots and structures do not have independent value outside of that purpose. However, the IRS published guidance in 2018 clarifying that the "value" of the employee-provided parking lots and structures is not relevant for determining the deduction disallowed to the employer.[82] Rather, the deduction disallowance amount should be based on the actual expense incurred by the employer, regardless of "value."[83]

In light of this IRS guidance, SDG&E may not deduct the costs of maintaining and operating its employee parking facilities. The addback of these nondeductible employee transportation benefits for 2018 – 2021 is reflected in the TMA Schedule.

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

2016 Adoption of Accounting Standard for Employee Stock-Based Compensation

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

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[81] TCJA Section 13304(c).

[82] IRS Notice 2018-99, 2018-52 I.R.B. 1067, at 7.

[83] *Id*.

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 scope of the items required to be tracked in the TMA. SDG&E believes, however, that including
5 the revenue impact of this book accounting change is consistent with the CPUC's desire to
6 increase transparency and visibility of accounting elections that potentially impact revenues;
7 therefore, SDG&E has tracked the 2016 revenue impact of the book accounting change, as
8 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. 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.[84] 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.[85] This revenue
19 requirement impact was also reflected in the 2016 TMA Schedule that was filed as part of
20 SDG&E's 2019 GRC Application.

21 <u>Alternative Fuel Refueling Property Credit</u>

22 IRC § 30C allows a tax credit equal to 30 percent of the cost of any qualified alternative
23 fuel vehicle refueling property placed into service during the year.[86] The credit is limited to
24 $30,000 per location per year.[87] The Section 30C credit had expired at the end of the 2017 tax
25 year. However, in December 2019, Congress retroactively reinstated the credit for the 2018-
26 2019 tax years and prospectively extended the credit for property installed on or before

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84 *See* D.04-12-015.

85 As discussed earlier in my testimony, SDG&E follows the CPUC's policy of excluding expenses not borne by ratepayers in the calculation of income tax expense, as articulated by the CPUC in OII 24.

86 IRC § 30C(a).

87 IRC § 30C(b)(1).

December 31, 2020.[88] Congress again extended the Section 30C credit in 2020 to apply to property installed on or before December 31, 2021.[89]

SDG&E installed electric vehicle charging stations during 2018 – 2021 that qualify for the reinstated Section 30C credit. The revenue impact of the reinstated Section 30C credit for 2018 – 2021 is reflected in the TMA Schedule.[90]

c. Other Net Revenue Changes

There was no additional cumulative revenue impact from net revenue changes beyond the impacts reflected in the other TMA categories.

d. Completion of Audits

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

e. IRS Rulings on Normalization Issues

Private Letter Ruling Request – ARAM Computation

As discussed earlier in the Income Taxes section of my testimony, on October 8, 2021, SDG&E filed a Private Letter Ruling request with the IRS National Office, requesting clarification on the ARAM calculation methodology on three specific normalization issues.

As noted, the IRS issued its Private Letter Ruling to SDG&E on April 28, 2022.[91] The IRS determined in its ruling that the CPUC's ARAM methodology that SDG&E is following as ordered in D.19-09-051 is inconsistent with the normalization rules, while SDG&E's proposed methodology is consistent with the normalization rules. Accordingly, SDG&E will seek recovery of the revenue requirement difference between the two methods by filing a Tier 2 advice letter, as directed by the Commission. Until SDG&E files and receives Commission approval for its forthcoming Tier 2 advice letter, SDG&E will continue tracking the revenue requirement difference between including and excluding cost of removal from the ARAM calculation in its TMA Schedule, as directed by the Commission.

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[88] P.L. 116-94, div. A, title I, Sec. 125(a).

[89] P.L. 116-260, Sec. 143(a); IRC § 30C(g).

[90] The IRC § 30C credit for 2018 and 2019 has yet to be included on a filed tax return, but SDG&E intends to include the credits on amended returns for 2018 and 2019.

[91] PLR-122706-21.

3. TMA Proposal for 2024 GRC Cycle

SDG&E proposes to continue the TMA for the 2024 TY GRC cycle, including the post-test-year period, under the rules and scope set forth in D.19-09-051 and Advice Letter 3462-E/2820-G. In addition, SDG&E recommends that the CPUC continue to review the TMA results in each subsequent GRC cycle.

V. CONCLUSION

SDG&E's estimated tax expense for TY 2024 for payroll taxes, ad valorem taxes, and income taxes should be adopted by the Commission. SDG&E's TMA, under the rules and scope set forth in D.19-09-051 and SDG&E's adopted tariffs, should be continued for the 2024 GRC cycle.

This concludes my prepared direct testimony.

VI. WITNESS QUALIFICATIONS

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

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

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

I have previously testified before the CPUC.

APPENDIX A

GLOSSARY OF TERMS

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
FERC:	Federal Energy Regulatory Commission
FICA:	Federal Insurance Contributions Act
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
PG&E:	Pacific Gas and Electric Company

RO:	Results of Operations
SBE:	California State Board of Equalization
SCE:	Southern California Edison Company
SDG&E:	San Diego Gas & Electric Company
SoCalGas:	Southern California Gas Company
SUI:	State Unemployment Insurance
TCJA:	Tax Cuts and Jobs Act
TMA:	Tax Memorandum Account
TRA 86:	Tax Reform Act of 1986
Treas. Reg.:	Treasury Regulations
Treasury:	United States Treasury Department
TY:	Test Year
UI:	Unemployment Insurance

APPENDIX B

TAX MEMORANDUM ACCOUNT TRACKING SCHEDULE
CUMULATIVE BALANCES AS OF DECEMBER 31, 2021

APPENDIX B

SDG&E
Tax Memorandum Account Tracking Schedule
For the Tax Years Ended December 31, 2016 - 2021

($ amounts in thousands)

	Revenue Impact of Incurred Amount [1]			Revenue Impact of GRC Authorized Amount (w/Attrition)			Revenue Impact of Difference Related to Changes in Tax Law, Tax Accounting, Tax Procedure, or Tax Policy			References	Comments
	Electric	Gas	Total	Electric	Gas	Total	Electric	Gas	Total		
1) Mandatory Changes in Tax Law, Tax Accounting, Tax Procedures, or Tax Policy											
Beginning Balance from 2016 TMA	-	-	-	-	-	-	-	-	-	[a]	
2017 Rate Base Impact of Basis Adjustments for 100% Bonus Depreciation on Post 9/27/17 Additions Placed in Service in 2017, Per the TCJA	(9,571)	(1,566)	(11,137)	(9,236)	(1,511)	(10,747)	(334)	(55)	(389)	[b]	
2018 Rate Base Impact of Basis Adjustments for 2018 Bonus Depreciation on Assets Acquired Pre 9/28/17, Per the TCJA	(338)	(51)	(389)	-	-	-	(338)	(51)	(389)	[c]	To be included on 2018 amended tax return to be filed
2019 Rate Base Impact of Basis Adjustments for 2019 & Prior Bonus Depreciation on Assets Acquired Pre 9/28/17, Per the TCJA	(467)	(85)	(552)	-	-	-	(467)	(85)	(552)	[d]	
2020 Rate Base Impact of Basis Adjustments for 2019 & Prior Bonus Depreciation on Assets Acquired Pre 9/28/17, Per the TCJA	(402)	(73)	(476)	-	-	-	(402)	(73)	(476)	[e]	
2021 Rate Base Impact of Basis Adjustments for 2019 & Prior Bonus Depreciation on Assets Acquired Pre 9/28/17, Per the TCJA	(341)	(63)	(404)	-	-	-	(341)	(63)	(404)	[f]	To be included on 2021 tax return to be filed
2019 Nondeductible Fringe Benefits	448	63	511	-	-	-	448	63	511	[g]	
2020 Nondeductible Fringe Benefits	214	38	252	-	-	-	214	38	252	[h]	
2021 Nondeductible Fringe Benefits	176	24	200	-	-	-	176	24	200	[i]	To be included on 2021 tax return to be filed
Revenue Impact of Differences as of 12/31/2021							(1,045)	(202)	(1,247)	[j] = [a] + [b] + [c] + [d] + [e] + [f] + [g] + [h] + [i]	
2) Elective Changes in Tax Law, Tax Accounting, Tax Procedures, or Tax Policy											
Beginning Balance from 2016 related to TMA Adoption of ASU 2016-09 - Accounting for Employee Stock-Based Compensation							(45)	(19)	(64)	[k]	
2018 Alternative Fuel 30C Credit	(7,516)		(7,516)	-	-	-	(7,516)	-	(7,516)	[l]	To be included on 2018 amended tax return to be filed
2019 Alternative Fuel 30C Credit	(1,248)		(1,248)	-	-	-	(1,248)	-	(1,248)	[m]	To be included on 2019 amended tax return to be filed
2020 Alternative Fuel 30C Credit	(38)		(38)	-	-	-	(38)	-	(38)	[n]	
2021 Alternative Fuel 30C Credit	(126)		(126)	-	-	-	(126)	-	(126)	[o]	To be included on 2021 tax return to be filed
Revenue Impact of Differences as of 12/31/2021							(8,974)	(19)	(8,993)	[p] = [k] + [l] + [m] + [n] + [o]	
3) Other Net Revenue Changes											
None							-	-	-	[q]	
4) Adjustments due to Completion of Audits											
None							-	-	-	[r]	
5) Adjustments due to IRS Private Letter Rulings on Normalization Issues											
2018 Impact of Including Book Accruals for COR in ARAM Amortization	(5,490)	(1,686)	(7,176)	(15,544)	(2,617)	(18,161)	10,054	931	10,984	[s]	To be addressed through Tier 2 Advice Letter to be filed
2018 Rate Base Impact of 2018 ARAM Amortization Adjustment	(701)	(65)	(766)	-	-	-	(701)	(65)	(766)	[t]	To be addressed through Tier 2 Advice Letter to be filed
2019 Impact of Including Book Accruals for COR in ARAM Amortization	(6,070)	(1,907)	(7,977)	(17,012)	(2,870)	(19,882)	10,942	964	11,905	[u]	To be addressed through Tier 2 Advice Letter to be filed
2019 Rate Base Impact of 2018 - 2019 ARAM Amortization Adjustments	(1,464)	(132)	(1,596)	-	-	-	(1,464)	(132)	(1,596)	[v]	To be addressed through Tier 2 Advice Letter to be filed
2020 Impact of Including Book Accruals for COR in ARAM Amortization	(6,070)	(1,907)	(7,977)	(17,012)	(2,870)	(19,882)	10,942	964	11,905	[w]	To be addressed through Tier 2 Advice Letter to be filed
2020 Rate Base Impact of 2018 - 2020 ARAM Amortization Adjustments	(2,226)	(199)	(2,425)	-	-	-	(2,226)	(199)	(2,425)	[x]	To be addressed through Tier 2 Advice Letter to be filed
2021 Impact of Including Book Accruals for COR in ARAM Amortization	(6,070)	(1,907)	(7,977)	(17,012)	(2,870)	(19,882)	10,942	964	11,905	[y]	To be addressed through Tier 2 Advice Letter to be filed
2021 Rate Base Impact of 2018 - 2021 ARAM Amortization Adjustments	(2,989)	(266)	(3,255)	-	-	-	(2,989)	(266)	(3,255)	[z]	To be addressed through Tier 2 Advice Letter to be filed
Revenue Impact of Differences as of 12/31/2021							35,499	3,159	38,658	[aa] = [s] + [t] + [u] + [v] + [w] + [x] + [y] + [z]	
Total Revenue Impact of Differences/Changes 12/31/2021							**25,479**	**2,939**	**28,418**	[ab] = [j] + [p] + [q] + [r] + [aa]	
Cumulative Interest (Payable)/Receivable as of 12/31/2021							185	43	228	[ac]	
Ending Cumulative Balance (Credit)/Debit as of 12/31/2021							**25,665**	**2,981**	**28,646**	[ad] = [ab] + [ac]	

NOTES:

[1] Incurred amounts are subject to change until the income tax returns are filed and the federal and state audits are completed.

SDG&E 2024 GRC Testimony Revision Log –August 2022

Exhibit	Witness	Page	Line or Table	Revision Detail
SDG&E-37	Ragan G. Reeves	RGR-iii	2nd bullet point	Changed ad valorem tax expense from "$166.5 million" to "$165.4 million"; Changed income tax expense from "$160.6 million" to "$158.3 million"
SDG&E-37	Ragan G. Reeves	RGR-3	Table SDG&E-RR-1	Revised table
SDG&E-37	Ragan G. Reeves	RGR-7	Table SDG&E-RR-2-1	Revised table
SDG&E-37	Ragan G. Reeves	RGR-8	Table SDG&E-RR-2-2	Revised table
SDG&E-37	Ragan G. Reeves	RGR-9	Table SDG&E-RR-2-3	Revised table
SDG&E-37	Ragan G. Reeves	RGR-25	Table SDG&E-RR-3-1	Revised table
SDG&E-37	Ragan G. Reeves	RGR-26	Table SDG&E-RR-3-2	Revised table
SDG&E-37	Ragan G. Reeves	RGR-27	Table SDG&E-RR-3-3	Revised table
SDG&E-37	Ragan G. Reeves	RGR-28	Table SDG&E-RR-4-1	Revised table
SDG&E-37	Ragan G. Reeves	RGR-29	Table SDG&E-RR-4-2	Revised table
SDG&E-37	Ragan G. Reeves	RGR-30	Table SDG&E-RR-4-3	Revised table