

Company: Southern California Gas Company (U 904 G)  
Proceeding: 2024 General Rate Case  
Application: A.22-05-015  
Exhibit: SCG-33-2R

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

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



**November 2022**

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## SUMMARY

- My testimony presents Southern California Gas Company's (SoCalGas) 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 \$58.5 million, ad valorem tax expense of \$167.0 million, and income tax expense of \$194.2 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 SoCalGas include: (1) a reduction of the federal corporate tax rate from 35% to 21%, effective beginning in 2018; (2) the elimination of the bonus depreciation deduction for regulated utilities; (3) the elimination of the deduction for transportation fringe benefits provided to employees beginning in 2018; (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; and (5) 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.

1                                   **SECOND REVISED PREPARED DIRECT TESTIMONY OF**  
2                                   **RAGAN G. REEVES**  
3                                   **(TAX)**

4 **I. INTRODUCTION**

5       **A. Summary of Proposals**

6           My testimony presents SoCalGas’s estimated tax expense for TY 2024 and explains how  
7 those estimates were derived. My testimony also presents the cumulative balances of the Tax  
8 Memorandum Account (TMA) as of December 31, 2021.

9       **B. Organization of Testimony**

10          SoCalGas incurs three categories of taxes: (1) payroll taxes; (2) ad valorem (*i.e.*,  
11 property) taxes; and (3) income taxes. I will discuss each of these tax expense categories in  
12 turn.<sup>1</sup> A summary table for each category of tax expense is presented at the end of each section.<sup>2</sup>

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 SoCalGas in this Application, taxes would be re-calculated to reflect  
16 the impact of those changes.

17 **II. PAYROLL TAXES**

18       **A. Introduction**

19          The purpose of this section is to provide an estimate of SoCalGas’s 2024 payroll tax  
20 expenses, and to describe the methodology used to develop SoCalGas’s estimate.

21       **B. Discussion**

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

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<sup>1</sup> The TMA discussion is included within the Income Taxes section of my testimony.

<sup>2</sup> 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.

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 2021, the OASDI tax rate was  
5 6.2% of wages up to a maximum wage base of \$142,800. The Medicare tax rate was 1.45% of  
6 wages with no maximum wage base. Based on rate schedules contained in the 2021 Annual  
7 Report published by the Social Security Administration (2021 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 2024 based on currently enacted law.<sup>3</sup> The OASDI wage base is  
10 \$147,000 for 2022 and is projected to increase to \$156,000 for 2023 and \$162,900 for 2024  
11 based on data reported in the 2021 Annual Report.<sup>4</sup>

12                                   **2.       Federal Unemployment Tax Act**

13                   The Federal Unemployment Tax Act (FUTA) tax rate is 0.6% for 2021 and 2022 on  
14 wages up to \$7,000. Based on currently enacted law, the FUTA tax rate is expected to remain at  
15 0.6% for 2023 and 2024, and the FUTA wage base is expected to remain at \$7,000 through 2024.

16                                   **3.       California State Unemployment Insurance**

17                   The California State Unemployment Insurance (SUI) is composed of two pieces: (1) the  
18 Unemployment Insurance (UI); and (2) the California Employment Training Tax (CET). The UI  
19 tax rate for 2021 and 2022 is 1.7% and 1.5% respectively, on wages up to \$7,000. The CET tax  
20 rate for 2021 and 2022 is an additional 0.1% on wages up to \$7,000. Based on currently enacted  
21 law, the UI tax rate is expected to remain at 1.5% for 2023 and 2024. The CET tax rate and  
22 wage bases for SoCalGas are not expected to change through 2024.

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<sup>3</sup> 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).

<sup>4</sup> See Table V.C1, Intermediate projections, 2021 Annual Report. If the projected OASDI wage bases change in a subsequent year’s Annual Report, SoCalGas 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 SoCalGas’s 2019 GRC (the 2019 GRC Decision). See Decision (D.)19-09-051, at 631, 641.



1 **III. AD VALOREM TAXES**

2 **A. Introduction**

3 The purpose of this section is to provide an estimate of SoCalGas’s ad valorem taxes that  
4 will be incurred during TY 2024, 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, with  
13 the Capitalized Earnings Ability (CEA) as a secondary indicator.

14 HCLD is the primary value gauge for closely rate-regulated property because it  
15 approximates rate base. HCLD is equal to the estimated cost of property that 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, materials and supplies on hand to operate the plant, and non-current (cushion) gas  
19 stored underground. Adjustments are made to add the value of possessory interests held by the  
20 utility on government-owned property and to deduct non-taxable licensed motor vehicles,  
21 software, leasehold improvements, business inventories, and other property not subject to ad  
22 valorem taxes. Finally, the HCLD indicator is adjusted by deducting the accumulated deferred  
23 federal income taxes on taxable property.

24 The CEA, or the income approach to value, is designed to recognize the concept that the  
25 value of business property is closely related to its ability to generate income. The CEA is a  
26 secondary indicator of value for public utility property because the income of public utility  
27 property is limited by regulation, and comparison to the income stream from similar properties is  
28 limited. The CEA indicator is used when the property being appraised is purchased in  
29 anticipation of receiving income (*i.e.*, rental property), and the actual future income stream can  
30 be reliably forecast, or a hypothetical income stream can be estimated by comparison to other

1 similar properties. The CEA is the preferred approach for the appraisal of properties when  
2 reliable sales data are not available, or when the cost approach does not yield reliable results.

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

8 In correlating the value indicators calculated by the SBE from information contained in  
9 the property statement, the SBE applied a weighting of 75% to the HCLD indicator and 25% to  
10 the CEA indicator to derive the total appraised valuation of SoCalGas's unitary property.<sup>5</sup>  
11 Added to the value of SoCalGas's unitary property is the value of SoCalGas's non-unitary  
12 property.<sup>6</sup> In estimating ad valorem taxes for ratemaking purposes, adjustments were made to  
13 exclude taxes resulting from: (a) the assessment of non-utility property since it is not included as  
14 an operating expense; and (b) Construction Work in Process (CWIP), which is capitalized rather  
15 than directly charged to ad valorem tax expense.

16 The SBE has followed the same assessment methodology for several years. And this  
17 method was approved by the CPUC the 2019 GRC Decision.<sup>7</sup> SoCalGas thus followed this  
18 methodology to estimate the assessed value for unitary property and the resulting ad valorem tax  
19 expense estimate for TY 2024.

20 The tax rate used to estimate California ad valorem taxes is the basic statewide tax rate of  
21 1% established under Proposition 13 plus an additional rate component of 0.4080%, which is a  
22 composite rate derived from dividing taxes paid to local jurisdictions by the total assessed value  
23 of property in all voter-approved local assessment districts as allowed under Proposition 13. The  
24 escalation in the rates from 2021 to 2024 represents the average historical rate of increase in  
25 local tax rates over the most recent five-year period. SoCalGas has used a five-year average of

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<sup>5</sup> Unitary property is property owned or used by a utility that the SBE has determined is used in SoCalGas'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.

<sup>6</sup> Non-unitary property is property owned or used by the utility that the SBE has determined is not used in SoCalGas's operating business.

<sup>7</sup> See D.19-09-051 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.").

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.

The estimated ad valorem taxes for SoCalGas’s Las Vegas Data Center, which is located in Nevada, are added to California ad valorem taxes as an “Other Adjustment” on the Ad Valorem summary table, Table SCG-RR-2 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.

**C. Summary of Estimated Ad Valorem Tax Expenses**

Table SCG-RR-2 below summarizes SoCalGas’s estimated ad valorem tax expenses.

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

<i>Line No.</i>	<i>Description</i>	<i>2021 Recorded</i>	<i>2022 Estimated</i>	<i>2023 Estimated</i>	<i>2024 Test Year</i>
1	Taxable Plant in Service	18,248,384	19,954,139	21,836,605	23,533,234
2	Taxable Reserve for Depreciation	(7,175,871)	(7,562,471)	(8,009,697)	(8,521,605)
3	Taxable Net Plant	11,072,513	12,391,668	13,826,908	15,011,628
4	Taxable Reserve for Def. Inc. Tax	(1,539,396)	(1,527,225)	(1,539,520)	(1,524,038)
5	Adjustment for Income Approach	(598,717)	(682,329)	(771,696)	(847,073)
6	Assessed Value - Non-Unitary	65,559	74,714	84,500	92,754
7	Net Assessable Value	8,999,959	10,256,828	11,600,192	12,733,271
8	Ad Valorem Tax Rate	1.4080395%	1.4320957%	1.4561520%	1.4802082%
9	Ad Valorem Tax - Fiscal Year	126,723	146,888	168,916	188,479
10	Other Adjustments	200	200	200	200
	<u>Fiscal Year</u>				
11	Total Operating Ad Valorem Tax	126,923	147,088	169,116	188,679
12	Capitalized Ad Valorem Tax	(10,483)	(11,315)	(11,728)	(11,898)
13	Net Operating Ad Valorem Tax	116,440	135,773	157,388	176,781
	<u>Calendar Year (Note 1)</u>				
14	Total Operating Ad Valorem Tax	120,487	136,255	157,352	178,148
15	Capitalized Ad Valorem Tax	(10,254)	(10,275)	(10,854)	(11,102)
16	Net Operating Ad Valorem Tax	110,233	125,980	146,498	167,046

(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 2021 to TY 2024 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 SoCalGas’s income tax expense  
8 for TY 2024, and to describe the assumptions and methodology used to calculate income tax  
9 expense. This section also presents and discusses the cumulative balances of the TMA as of  
10 December 31, 2021.

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

12                   **1.     Impact of the Tax Cuts and Jobs Act**

13           The TCJA was enacted on December 22, 2017.<sup>8</sup> It was the most comprehensive tax  
14 reform legislation to be enacted into law in more than thirty years. The changes to federal tax  
15 law under the TCJA affected both individuals and corporations. The TCJA also included  
16 provisions specific to regulated utilities such as SoCalGas. Most of the changes to federal tax  
17 law under the TCJA became effective beginning on January 1, 2018, although certain changes  
18 related to bonus depreciation became effective on September 28, 2017. The most significant  
19 change under the TCJA for corporations generally, and for regulated utility corporations  
20 specifically, was the lowering of the federal corporate tax rate from 35% to 21% beginning in  
21 2018. The impact of the TCJA on SoCalGas’s income tax expense for TY 2024 is incorporated  
22 in the assumptions and methodology used to calculate income tax expense, which is discussed in  
23 remainder of this section.

24                   **2.     Methodology**

25           SoCalGas’s operating income is subject to federal income tax and the California  
26 Corporation Franchise Tax (CCFT). Income tax expense is a function of cost-of-service amounts  
27 and capital expenditures adopted by the CPUC, as adjusted to comply with income tax rules.  
28 Accordingly, the calculation of ratemaking income taxes is dependent upon federal and state tax

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<sup>8</sup> Pub. L. No. 115-97, 131 Stat. 2054 (2017).

1 laws, prior CPUC decisions with general applicability to all utilities, and decisions with specific  
2 reference to SoCalGas.

3 Consistent with CPUC D.84-05-036 issued in Order Instituting Investigation (OII) 24, the  
4 income tax estimates contained in this section are based on SoCalGas's stand-alone taxes, not on  
5 an allocation of tax expense from Sempra Energy, the parent company of SoCalGas.<sup>9</sup>

6 Another issue considered by the CPUC in OII 24 was whether expenses not borne by  
7 customers should be included as income tax deductions in computing estimated TY income tax  
8 expense. The CPUC stated that it had consistently calculated income taxes for ratemaking  
9 purposes based on the cost of service developed from authorized expenses.<sup>10</sup> The CPUC also  
10 found that if they were to include expenses not subject to rate recovery as a deduction in  
11 calculating taxable income, stockholders would be penalized by a reduction in their net income  
12 equal to the full amount of the expenditures, because they would have no offsetting tax  
13 deduction.<sup>11</sup> The Commission concluded that their method of excluding expenses not borne by  
14 customers in the calculation of TY income tax expense is reasonable and should continue.<sup>12</sup> As  
15 such, SoCalGas follows this conclusion of law from OII 24 in this GRC proceeding, as it has  
16 done in prior GRCs.

17 The estimates contained in this section were calculated using current federal and state tax  
18 laws enacted through the date of this testimony. SoCalGas has not attempted to forecast any  
19 future changes in tax law in the income tax calculations. SoCalGas has utilized current federal  
20 and state statutory tax rates of 21% and 8.84%, respectively, in developing its estimate of federal  
21 and state income tax expense.

22 As prescribed in D.84-05-036, SoCalGas used the statutory federal tax rate of 21% and  
23 the statutory state tax rate of 8.84% in its development of the net-to-gross multiplier used to  
24 gross-up tax expense to a revenue requirement.<sup>13</sup>

25 State income tax expense has been computed by reducing operating income by operating  
26 expenses, including property taxes and payroll taxes, and making certain permanent and flow

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<sup>9</sup> 1984 Cal. PUC LEXIS 1325 at \*57-58 (Finding of Fact #12); 15 CPUC 2d 42.

<sup>10</sup> *Id.* at \*15.

<sup>11</sup> *Id.* at \*16-18.

<sup>12</sup> *Id.* at \*62 (Conclusion of Law 2).

<sup>13</sup> 1984 Cal. PUC LEXIS 1325 at \*62-63 (Conclusion of Law 9).

1 through tax adjustments for differences in the book and state tax treatment of items of income  
2 and expense (Schedule M adjustments) as explained in more detail later in this section.

3 Consistent with the CPUC policy discussed in D.93848,<sup>14</sup> a flow through accounting  
4 methodology was utilized in estimating state tax expense.<sup>15</sup>

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

9 Where required, SoCalGas has followed the normalization rules contained in Internal  
10 Revenue Code Section (IRC §) 168 and Treasury Regulations Section (Treas. Reg. §) 1.167(l)-1  
11 in computing federal income tax expense.<sup>16</sup> Accordingly, federal tax depreciation on post-1980  
12 vintage assets has been “normalized” by using a book life and method to calculate tax  
13 depreciation. Consistent with CPUC policy, where normalization is not required by the IRC,  
14 SoCalGas generally has flowed through tax deductions. For example, tax depreciation on pre-  
15 1981 vintage assets have been flowed through as an adjustment to federal tax expense as  
16 required by D.93848.<sup>17</sup>

17 Tax expense based on income has been reduced by the amortization of deferred  
18 Investment Tax Credits (ITC) generated in prior years in accordance with SoCalGas’s election  
19 under applicable tax law<sup>18</sup> to ratably flow through the ITC benefit as a reduction to ratemaking  
20 tax expense at a rate not to exceed the book life of the property that generated the ITC. This  
21 application conforms to the treatment of deferred ITC amortization mandated by D.88-01-061<sup>19</sup>  
22 and is the same treatment employed by SoCalGas in prior rate cases. SoCalGas has a small  
23 portion of deferred ITC that reduced rate base, pursuant to an election made under applicable

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<sup>14</sup> 1981 Cal. PUC LEXIS 1240; 7 CPUC 2d 332.

<sup>15</sup> 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.

<sup>16</sup> Normalized tax accounting follows the book treatment for items of income and expense in the revenue requirement calculation.

<sup>17</sup> 1981 Cal. PUC LEXIS 1240; 7 CPUC 2d 332.

<sup>18</sup> SoCalGas’s election under former IRC § 46(f)(2).

<sup>19</sup> 1988 Cal. PUC LEXIS 102; 27 CPUC 2d 310.

1 law<sup>20</sup> by a predecessor company, Pacific Lighting Gas Supply Company (Pacific Lighting),  
2 which merged with SoCalGas in November 1985. As a successor in interest, SoCalGas  
3 continues to amortize deferred ITC generated by Pacific Lighting as a ratable restoration to rate  
4 base.

5 SoCalGas's federal income tax expense has been reduced by the amortization of  
6 remaining excess deferred federal income taxes resulting from a reduction in the federal income  
7 tax rate from a high of 41% prior to the Tax Reform Act of 1986 (TRA 86) to the current 21%  
8 under the TCJA beginning in 2018, utilizing ARAM as required by Internal Revenue Service  
9 (IRS) normalization rules and mandated by D.88-01-061.<sup>21</sup> Additionally, ARAM is the required  
10 method for amortizing plant-related excess accumulated deferred federal income tax (ADFIT)  
11 resulting from the tax rate reduction under the TCJA.<sup>22</sup> Only a small amount of excess ADFIT  
12 remains from the decrease in tax rate under TRA 86. The ARAM amount increased significantly  
13 beginning in 2018, due to the reduction in the federal corporate income tax rate from 35% to  
14 21% under the TCJA. The ARAM rules and methodology required under the TCJA are  
15 discussed in more detail in Section IV.C.3 below.

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

### 23 **3. Schedule M Items and Other Specific Tax Deductions**

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

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<sup>20</sup> Pacific Lighting's election under former IRC § 46(f)(1).

<sup>21</sup> 1988 Cal. PUC LEXIS 102 at \*95-96.

<sup>22</sup> TCJA Section 13001(d)(3)(B).

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

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

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

15           Prior Year CCFT. Federal law allows a deduction for state income taxes paid. In  
16 California, this is the CCFT deduction. For ratemaking purposes, D.89-11-058<sup>23</sup> specifies that  
17 the allowable deduction is the prior years’ CPUC-adopted CCFT, not the current year CCFT.  
18 Since there is, as of yet, no CPUC-adopted CCFT, SoCalGas has used the prior year’s CCFT  
19 estimate in calculating federal tax expense for TY 2024.

20           Internally-Developed Software. For financial accounting purposes, software  
21 expenditures are capitalized and amortized to expense over various lives. For tax purposes, a  
22 current-year deduction is allowed under IRC § 174 for internally-developed software  
23 expenditures paid or incurred through 2021. For internally-developed software expenditures  
24 paid or incurred beginning in 2022, the TCJA changed the tax treatment from a deduction of the  
25 full amount in the year incurred to a five-year amortization period for such expenditures.<sup>24</sup> The  
26 five-year amortization period begins with the mid-point of the taxable year in which such  
27 expenditures are paid or incurred.<sup>25</sup> Accordingly, beginning in 2022, only a half-year of

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<sup>23</sup> 1989 Cal. PUC LEXIS 815 at \*34, Conclusion of Law 1; 33 CPUC 2d 495.

<sup>24</sup> TCJA Sections 13206(a), (c)(3), and (e).

<sup>25</sup> *Id.* at 13206(a)(2)(B).

1 amortization is allowed as a deduction in the year the internally-developed software expenditures  
2 are paid or incurred.<sup>26</sup>

3 SoCalGas has deducted internally developed software expenditures as a flow-through  
4 deduction pursuant to D.84-05-036.<sup>27</sup> IRC § 167(f)<sup>28</sup> requires capitalization of un-modified, or  
5 “canned” software. SoCalGas applies normalized tax accounting treatment to expenditures for  
6 canned software pursuant to D.84-05-036.

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

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

21 Federal Cost of Removal. SoCalGas follows the guidance in IRS Revenue Ruling 2000-  
22 7,<sup>29</sup> which provides a current tax deduction for actual costs to remove assets retired from service  
23 in the year that those costs are incurred. For book purposes, estimates of such costs are  
24 capitalized and depreciated over the life of the assets. Thus, there is a timing difference between  
25 tax and book. To be consistent with the treatment of property that is being depreciated under the

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<sup>26</sup> 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 (RO) Model, and the tax module pulls in the forecasted spend data from the rate base module.

<sup>27</sup> 1984 Cal. PUC LEXIS 1325.

<sup>28</sup> IRC § 167(f) required capitalization of un-modified software purchased after August 10, 1993.

<sup>29</sup> 2000-1 C.B. 712.

1 Accelerated Cost Recovery System (ACRS) or the Modified Accelerated Cost Recovery System  
2 (MACRS) as described above, SoCalGas normalizes the costs to remove those assets for federal  
3 tax purposes and flows through the federal removal costs only on pre-1981 vintage assets retired  
4 from service. This approach is consistent with prior GRCs.

5 State Cost of Removal. California did not adopt the federal ACRS or MACRS  
6 depreciation systems, choosing instead to remain on the ADR system. Accordingly, SoCalGas  
7 flows through removal costs for CCFT purposes irrespective of the vintage of the underlying  
8 assets per D.84-05-036.<sup>30</sup> This treatment is consistent with prior GRCs.

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

14 Employee Transportation Benefits. Prior to the enactment of the TCJA, employers  
15 generally were allowed a deduction for the costs associated with providing transportation fringe  
16 benefits to its employees, such as parking and commuter rail costs, under IRC Section 274. The  
17 TCJA amended IRC § 274 effective January 1, 2018 to eliminate the deduction for expenses  
18 incurred in providing any transportation to employees, or any payment or reimbursement for  
19 transportation fringe benefits to employees, except as necessary to ensure the safety of the  
20 employee.<sup>31</sup> SoCalGas continues to provide transportation fringe benefits to its employees. But  
21 since such costs are no longer deductible under the TCJA, SoCalGas must add back these costs  
22 in computing taxable income.

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

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<sup>30</sup> 1984 Cal. PUC LEXIS 1325 at \*59 (Finding of Fact 23).

<sup>31</sup> TCJA Section 13304(c).

1           **C.      Discussion of Deferred Taxes**

2           The ADFIT resulting from the difference between normalized tax depreciation computed  
3 using a book life and book method and the comparable tax depreciation computed using ACRS  
4 or MACRS has been included as an adjustment to rate base in this GRC (see the testimony of  
5 Patrick D. Moersen (Exhibit SCG-31), for a discussion of rate base). SoCalGas’s treatment of  
6 deferred taxes is in accordance with IRC § 168(i)(9), Treas. Reg. § 1.167(l)-1, and numerous  
7 related IRS rulings that taken together constitute the “tax normalization” requirements.

8           All current law has been followed in the development of deferred federal income taxes.  
9 Accumulated deferred taxes for TY 2024 were developed on a monthly basis and prorated in  
10 accordance with the normalization requirements in Treas. Reg. § 1.167(l)-1(h)(6)(ii).<sup>32</sup>

11                   **1.      Bonus Depreciation**

12                           **a.      Pre-TCJA**

13           Prior to the enactment of the TCJA, the bonus depreciation rules allowed regulated  
14 utilities such as SoCalGas to immediately expense a specified percentage of qualifying property  
15 placed into service in a particular year, rather than requiring the taxpayer to depreciate the full  
16 amount of the property over multiple years.<sup>33</sup>

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

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<sup>32</sup> 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.

<sup>33</sup> Former IRC § 168(k), prior to amendment by the TCJA.

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

2           The bonus depreciation rules under the TCJA supersede the prior bonus depreciation  
3 rules for qualified property acquired pursuant to a written binding contract and placed in service  
4 after September 27, 2017 (or for self-constructed property for which construction began after  
5 such date).<sup>34</sup> For such property, the TCJA generally increased the bonus depreciation allowance  
6 to 100 percent through the end of 2022.<sup>35</sup> However, the TCJA also specified that bonus  
7 depreciation is not available for assets acquired or self-constructed in the trade or business of the  
8 furnishing or sale of:

- 9                           (I) electric energy, water, or sewage disposal services, (II) gas or steam  
10                           though a local distribution system, or (III) transportation of gas or steam  
11                           by pipeline, if the rates for such furnishing or sale, as the case may be,  
12                           have been established or approved by a State or political subdivision  
13                           thereof, by any agency or instrumentality of the United States, by a public  
14                           service or public utility commission or other similar body of any State or  
15                           political subdivision thereof, or by the governing or ratemaking body of an  
16                           electric cooperative.<sup>36</sup>

17           Accordingly, for property acquired (or self-constructed) and placed in service after  
18 September 27, 2017, the TCJA generally eliminated the bonus depreciation deduction for  
19 regulated utilities such as SoCalGas. The TCJA included a bonus depreciation transition rule for  
20 property that was acquired (or for which self-construction began) before September 27, 2017.<sup>37</sup>  
21 But it was unclear from the statute how that transition rule applied to regulated utilities.

22           On September 13, 2019, and on November 5, 2020, the IRS and the United States  
23 Treasury Department (Treasury) issued final regulations clarifying the TCJA’s changes to the  
24 bonus depreciation rules. The final regulations clarified that: (1) for property purchased or self-  
25 constructed by regulated utilities after September 27, 2017 and placed in service on or before  
26 December 31, 2017, such property was eligible for 100% bonus depreciation under the general  
27 rule of the TCJA;<sup>38</sup> and (2) for property acquired (or for which self-construction began) by  
28 regulated utilities prior to September 27, 2017, and placed into service in 2018 or later, the pre-

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<sup>34</sup> TCJA Section 13201(h)(1).

<sup>35</sup> *Id.* at 13201(a)(2).

<sup>36</sup> TCJA Sections 13201(d)(9)(A) and 13301(a).

<sup>37</sup> *Id.* at 13201(a)(8).

<sup>38</sup> Treas. Reg. § 1.168(k)-2(b)(2)(ii)(F) and (f)(3).

1 TCJA rules and deduction percentages applied.<sup>39</sup> Under the pre-TCJA rules, the specified  
2 percentage of allowable bonus depreciation was 40% and 30% for property placed in service in  
3 2018 and 2019, respectively.<sup>40</sup> Unless the property qualified as Long Production Period Property  
4 (LPPP),<sup>41</sup> there was no bonus depreciation allowed for property placed in service in 2020 or  
5 later. For LPPP, the pre-TCJA rules specified a bonus depreciation percentage of 50%, 40%,  
6 and 30% for property placed in service in 2018, 2019, and 2020, respectively.<sup>42</sup> Bonus  
7 depreciation was not allowed for LPPP placed in service in 2021 or later.

8 Accordingly, under both the general rule and the transition rules of the TCJA, no bonus  
9 depreciation is allowed for regulated utilities for property placed in service in 2021 or later.  
10 Therefore, no bonus depreciation deductions are reflected in the forecasts for any of the years  
11 included in SoCalGas's 2024 GRC. However, the residual impact of bonus depreciation taken  
12 on qualified property placed in service in prior periods, when bonus depreciation was allowed, is  
13 reflected in the accumulated deferred income tax balances for 2021-2024.

## 14 **2. Contributions-in-Aid-of-Construction**

15 Contributions-in-aid-of-construction (CIAC) are non-refundable contributions collected  
16 from utility customers in the form of money – or its equivalent – toward the construction of  
17 plant, such as customer-requested relocations. CIAC became taxable under the TRA 86. The  
18 CPUC proposed the Maryland Method or Method 5 as acceptable alternatives for the ratemaking  
19 treatment of CIAC in D.87-09-026.<sup>43</sup> SoCalGas elected Method 5 to account for the tax impacts  
20 of CIAC, and the related income tax component of the CIAC (ITCC) as required by the TRA 86.  
21 In accordance with D.87-09-026, SoCalGas has increased rate base for the tax paid on CIAC  
22 subsequent to February 10, 1987, the date that CIAC became taxable under the TRA 86. The  
23 increase to rate base related to CIAC tax impacts is reversed through tax depreciation over the  
24 tax life of the constructed property.

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<sup>39</sup> *Id.* at § 1.168(k)-2(c)(9)(i), Example 1.

<sup>40</sup> IRC § 168(k)(8).

<sup>41</sup> 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).

<sup>42</sup> IRC § 168(k)(8).

<sup>43</sup> 1987 Cal. PUC LEXIS 195; 25 CPUC 2d 299.

1 ITCC represents the tax gross-up for CIAC. It also became taxable under TRA 86.  
2 These tax gross-up amounts reflect the present value of tax paid upon receipt of CIAC, less the  
3 future tax benefits to be received through tax depreciation over the tax life of the constructed  
4 property. ITCC is included as a reduction to rate base and is amortized to miscellaneous  
5 revenues over the tax life of the constructed property as instructed by D.87-09-026.<sup>44</sup>

### 6 **3. Excess Deferred Taxes Related to the TCJA**

7 SoCalGas recomputed its ADFIT balances as of January 1, 2018 to reflect the reduction  
8 in the federal corporate income tax rate from 35% to 21% under the TCJA. The difference in the  
9 ADFIT balance under the old tax rate versus under the new tax rate represents the excess  
10 deferred tax reserve created by the TCJA. The TCJA defines the “excess tax reserve” as “(i) the  
11 reserve for deferred taxes (as described in section 168(i)(9)(A)(ii) of the Internal Revenue Code  
12 of 1986) as of the day before the corporate rate reductions . . . made by this section take effect,  
13 over (ii) the amount which would be the balance in such reserve if the amount of such reserve  
14 were determined by assuming that the corporate rate reductions provided in this Act were in  
15 effect for all prior periods.”<sup>45</sup>

#### 16 **a. Protected Assets**

17 SoCalGas has begun the process of returning the excess ADFIT to its customers. But in  
18 doing so, SoCalGas must adhere to the timing rules and other requirements under the TCJA.  
19 Failure to follow these rules and procedures will result in a normalization violation.<sup>46</sup> The TCJA  
20 specifies that utilities may not return the excess ADFIT associated with utility plant assets  
21 (excess plant-based ADFIT) more rapidly than ratably over the life of the underlying assets.<sup>47</sup>  
22 Specifically, utilities are generally not permitted, in computing costs of service for ratemaking  
23 purposes, to refund excess plant-based ADFIT more rapidly or greater than the reductions  
24 permitted by the ARAM approach, which requires amortization of the excess tax reserve over the

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<sup>44</sup> *Id.*

<sup>45</sup> 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.

<sup>46</sup> TCJA Section 13001(d)(4).

<sup>47</sup> *Id.* at 13001(d)(1).

1 remaining regulatory lives of the property that gave rise to the ADFIT.<sup>48</sup> The TCJA defines  
2 ARAM as follows:

3           The average rate assumption method is the method under which the excess  
4           in the reserve for deferred taxes is reduced over the remaining lives of the  
5           property as used in its regulated books of account which gave rise to the  
6           reserve for deferred taxes. Under such method, during the time period in  
7           which the timing differences for the property reverse, the amount of the  
8           adjustment to the reserve for the deferred taxes is calculated by  
9           multiplying – (i) the ratio of the aggregate deferred taxes for the property  
10           to the aggregate timing differences for the property as of the beginning of  
11           the period in question, by (ii) the amount of the timing differences which  
12           reverse during such period.<sup>49</sup>

13           The requirement to use ARAM applies only to excess deferred taxes on plant-based  
14           assets that are subject to the IRS normalization rules (also known as “protected” assets). If a  
15           utility’s books and records do not contain the vintage data necessary to apply ARAM, the TCJA  
16           allows the utility to use an alternative method that amortizes the excess plant-based ADFIT  
17           ratably over the remaining average life or composite rate used to compute depreciation for  
18           regulatory purposes.<sup>50</sup>

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

23           Among the TCJA impacts considered by the CPUC in the 2019 GRC Decision was the  
24           proper computation of ARAM – specifically, when computing the ARAM (as per TCJA section  
25           13001(d)(3)(B)), whether the cost of removal should be included or excluded from book  
26           depreciation in the ARAM calculation.<sup>51</sup> Ultimately, the CPUC and SoCalGas disagreed on the  
27           inclusion of cost of removal in the ARAM calculation. SoCalGas’s position was that to be  
28           consistent with the normalization rules, cost of removal should be excluded from the ARAM

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<sup>48</sup> *Id.* at 13001(d)(3)(B).

<sup>49</sup> *Id.* at 13001(d)(3)(B).

<sup>50</sup> *Id.* at 13001(d)(3)(C). SoCalGas has the vintage data needed to compute ARAM and thus does not fall within this exception.

<sup>51</sup> “Cost of removal” is the cost of demolishing, dismantling, tearing down, or otherwise removing electric or gas plant, including incidental transportation and handling costs.

1 computation. However, the CPUC concluded that unless otherwise directed by the IRS,  
2 SoCalGas should not exclude cost of removal from the ARAM computation. Specifically, the  
3 decision includes the following analysis and conclusion from the CPUC:<sup>52</sup>

4           The IRS does not provide sufficient ARAM guidance regarding whether  
5           SoCalGas’ adjustment concerning removal costs is appropriate, but we  
6           find that excluding costs of removal has the effect of delaying the refund  
7           to ratepayers as compared to not applying this adjustment. This is because  
8           the ARAM calculation compares accelerated depreciation to book  
9           depreciation and when there is reduced book depreciation (due to  
10           excluding cost of removal), there is less total ARAM return of excess  
11           ADIT. Absent clear guidance from the IRS, we find it more reasonable to  
12           disallow this adjustment as we do not believe that this violates the IRS  
13           normalization rules concerning return of excess ADIT in the TCJA and so  
14           as not to delay the refund to ratepayers.

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

17           Notwithstanding the CPUC’s determination, the CPUC found it “prudent and reasonable  
18 to allow SoCalGas to track the revenue requirement difference between including and excluding  
19 cost of removal from the ARAM calculation,” and to allow SoCalGas to seek recovery of such  
20 difference in the event the IRS issues a ruling or releases further guidance indicating that cost of  
21 removal should be excluded from the ARAM calculation.<sup>53</sup> In such case, the CPUC stated that  
22 SoCalGas “should seek recovery of any difference in costs by filing a Tier 2 advice letter seeking  
23 appropriate adjustment to its revenue requirement.”<sup>54</sup>

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

- 27           1.       Whether the CPUC’s method of including book cost of removal in the ARAM  
28                   calculation for the return of excess deferred taxes to ratepayers is inconsistent  
29                   with the normalization rules.
- 30           2.       Whether the method proposed by SoCalGas of excluding book cost of removal in  
31                   the ARAM calculation for the return of excess deferred taxes to ratepayers is  
32                   consistent with the normalization rules.

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<sup>52</sup> D.19-09-051 at 637-638.

<sup>53</sup> *Id.* at 638.

<sup>54</sup> *Id.*

- 1 3. Whether SoCalGas’s use of the method proposed by the CPUC, as required by the  
2 2019 GRC Decision, will not be a violation of the normalization rules, provided  
3 the Commission (i) approves the method proposed by SoCalGas (or otherwise  
4 required by the Service) and (ii) allows SoCalGas to recover any difference in the  
5 rates charged to customers under the Commission’s proposed method and  
6 SoCalGas’ method under the procedures for such recovery as set forth in the 2019  
7 GRC Decision.

8 On May 1, 2022, the IRS issued its Private Letter Ruling to SoCalGas, reaching a  
9 different conclusion than D.19-09-051.<sup>55</sup> Specifically, the IRS concluded that:

- 10 4. The CPUC’s method of including book cost of removal in the ARAM calculation  
11 for the return of excess deferred taxes to ratepayers is inconsistent with the  
12 normalization rules.
- 13 5. The method proposed by SoCalGas of excluding book cost of removal in the  
14 ARAM calculation for the return of excess deferred taxes to ratepayers is  
15 consistent with the normalization rules.
- 16 6. SoCalGas’s use of the method proposed by the CPUC, as reflected in the 2019  
17 GRC Decision, is not a violation of the normalization rules, provided that the  
18 Commission: (i) approves the method proposed by SoCalGas (or otherwise  
19 required by the Service); and (ii) allows SoCalGas to recover any difference in the  
20 rates charged to customers under the Commission’s proposed method and  
21 SoCalGas’ method.

22 Accordingly, the ARAM forecasts included in this 2024 GRC have excluded book cost of  
23 removal from the ARAM calculation, consistent with the IRS’s conclusions. In addition, as  
24 noted, because SoCalGas’s Private Letter Ruling makes findings are different than those adopted  
25 in D.19-09-051, SoCalGas will follow the process outlined in D.19-09-051 and file a Tier 2  
26 advice letter seeking appropriate adjustment to its revenue requirement.<sup>56</sup>

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<sup>55</sup> PLR-122708-21.

<sup>56</sup> The IRS’s conclusions in SoCalGas’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.

1 **b. Unprotected Assets**

2 As stated above, the requirement to use ARAM applies only to excess ADFIT on plant-  
3 based assets that are subject to the IRS normalization rules (also known as “protected” assets).  
4 In contrast, “unprotected” assets are not subject to the IRS normalization rules. There are thus  
5 no IRS restrictions regarding how excess ADFIT on unprotected assets are returned to  
6 ratepayers.

7 In the 2019 GRC Decision, the Commission adopted TURN’s proposal for returning  
8 excess ADFIT on unprotected assets to ratepayers.<sup>57</sup> TURN had proposed to amortize and return  
9 to ratepayers the excess ADFIT from SoCalGas’s unprotected assets over a six-year period, with  
10 the exception of the unprotected ADFIT related to the cost or removal tax deduction.<sup>58</sup> Cost of  
11 removal is not allowed as a deduction for tax purposes until the property is removed, which  
12 generally occurs at the end of the property’s useful life.

13 In contrast, cost of removal is expensed ratably over the property’s useful life for book  
14 purposes. This timing difference between book and tax creates a deferred tax asset, which  
15 causes rates to increase in the future as the excess ADFIT related to cost of removal is reversed  
16 over time. Because of the unique aspects of the cost of removal tax deduction as compared to  
17 SoCalGas’s other unprotected assets, TURN proposed to “apply the same ARAM-based  
18 treatment” to the excess ADFIT related to the cost of removal tax deduction “as for protected  
19 assets,” instead of the six-year amortization period TURN had proposed for SoCalGas’s other  
20 unprotected assets.<sup>59</sup>

21 SoCalGas has continued to follow the Commission’s instructions from the 2019 GRC  
22 Decision regarding the treatment of unprotected excess ADFIT. Such treatment is reflected in  
23 the 2024 GRC forecasts. SoCalGas began amortizing the unprotected excess ADFIT over a six-  
24 year period (except for the excess ADFIT related to cost of removal) beginning in 2018.  
25 Accordingly, these unprotected excess ADFIT amounts are fully amortized by the end of 2023.  
26 Also, consistent with the 2019 GRC Decision, SoCalGas has continued to apply ARAM-based

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<sup>57</sup> D.19-09-051 at 638.

<sup>58</sup> 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.

<sup>59</sup> Ex. TURN-03 (Marcus), at 83.

1 treatment to amortize the excess ADFIT associated with the cost of removal tax deduction in its  
 2 2024 GRC forecasts.

3 **D. Summary Tables**

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

6 **TABLE SCG-RR-3-1**  
 7 **Southern California Gas Company**  
 8 **Calculation of Federal & State Income Taxes**  
 9 **(\$ in Thousands)**

<i>Line</i>		<i>2021</i>	<i>2022</i>	<i>2023</i>	<i>2024</i>
<i>No.</i>	<i>Description</i>	<i>Recorded</i>	<i>Estimated</i>	<i>Estimated</i>	<i>Test Year</i>
1	Total Operating Revenue	3,208,012	3,665,608	3,937,689	4,398,305
2	O&M Expenses	(1,595,478)	(1,811,063)	(1,882,548)	(2,035,458)
3	Taxes Other than Income Taxes	(151,516)	(176,364)	(201,699)	(225,524)
4	Book Income Before Depr. & Income Taxes	1,461,017	1,678,181	1,853,442	2,137,324
5	State Tax Adjustments	(1,326,147)	(1,462,042)	(1,590,545)	(1,623,967)
6	Taxable Income	134,870	216,138	262,897	513,357
7	CCFT Rate	8.84%	8.84%	8.84%	8.84%
8	<b>California Corporate Franchise Tax</b>	<b>11,923</b>	<b>19,107</b>	<b>23,240</b>	<b>45,381</b>
9	Book Income Before Depr. & Income Taxes (Line 4, above)	1,461,017	1,678,181	1,853,442	2,137,324
10	Federal Tax Adjustments	(1,114,453)	(1,035,592)	(1,128,306)	(1,372,868)
11	Taxable Income	346,564	642,588	725,135	764,455
12	Federal Income Tax Rate	21%	21%	21%	21%
13	Federal Income Tax Before Credits	72,778	134,944	152,278	160,536
14	Investment Tax Credit Amortization	(1,053)	(967)	(884)	(684)
15	Amortization of Excess Deferred Taxes	(10,350)	(9,915)	(10,038)	(9,926)
16	Other	(1,174)	(1,131)	(1,131)	(1,131)
17	<b>Total Federal Income Tax</b>	<b>60,202</b>	<b>122,931</b>	<b>140,225</b>	<b>148,794</b>

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

<i>Line No.</i>	<i>Description</i>	<i>2021 Recorded</i>	<i>2022 Estimated</i>	<i>2023 Estimated</i>	<i>2024 Test Year</i>
	<b><u>Federal Tax Adjustments:</u></b>				
1	Tax Depreciation	(531,531)	(572,307)	(615,480)	(787,887)
2	Fixed Charges – Operating	(181,350)	(206,566)	(230,913)	(257,183)
3	Repairs	(187,268)	(181,065)	(159,024)	(166,423)
4	Software Development	(151,944)	(17,988)	(59,504)	(103,203)
5	Cost of Removal	(47,049)	(38,513)	(36,145)	(27,951)
6	Ad Valorem Tax - Fiscal/Calendar	(6,207)	(9,793)	(10,891)	(9,736)
7	Preferred Dividend & Other	(800)	(798)	(798)	(798)
8	Disallowed Transportation Fringe Benefits	3,223	3,360	3,554	3,554
9	Prior Year Calif. Corp. Franchise Tax	(11,527)	(11,923)	(19,107)	(23,240)
10	Total Federal Tax Adj. (Deduction)	<u>(1,114,453)</u>	<u>(1,035,592)</u>	<u>(1,128,306)</u>	<u>(1,372,868)</u>
	<b><u>State Tax Adjustments:</u></b>				
11	Tax Depreciation	(660,415)	(754,533)	(832,216)	(894,429)
12	Fixed Charges – Operating	(181,219)	(206,454)	(230,817)	(257,101)
13	Repairs	(187,268)	(181,065)	(159,024)	(166,423)
14	Software Development	(151,944)	(179,876)	(235,291)	(201,696)
15	Cost of Removal	(139,095)	(130,322)	(122,306)	(94,582)
16	Ad Valorem Tax - Fiscal/Calendar	(6,207)	(9,793)	(10,891)	(9,736)
17	Preferred Dividend & Other	-	-	-	-
18	Total State Tax Adj. (Deduction)	<u>(1,326,147)</u>	<u>(1,462,042)</u>	<u>(1,590,545)</u>	<u>(1,623,967)</u>

**E. Results**

The overall increase in federal and state income tax expense from 2021 to TY 2024 is primarily a function of increasing book income before taxes resulting from the return on an increasing rate base (see the testimony of Patrick D. Moersen, Exhibit SCG-31, for a discussion of rate base). Federal and state tax adjustments are also growing annually, which, in turn, partially offset the growth in book income before taxes from 2021 to TY 2024.

1           **F.     Tax Memorandum Account**

2                   **1.     Background**

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

11           In the 2019 GRC Decision, the Commission concluded that the TMA should be  
12 maintained for the 2019 GRC cycle.<sup>64</sup> The Commission also clarified that “the TMA is not  
13 meant as a true-up mechanism between actual and forecast tax expenses that are not caused by  
14 changes in tax law, tax accounting methods, tax procedures, and tax policy,” and that the TMA  
15 “only tracks differences arising from changes in tax law, tax accounting changes, tax policy  
16 changes, or procedural changes.”<sup>65</sup> The Commission concluded that “SoCalGas and SDG&E  
17 may file separate Tier 1 advice letters within 45 days from the effective date of this decision to  
18 implement any necessary changes to their respective TMAs consistent with this decision.”<sup>66</sup>

19           Pursuant to the Commission’s directive, SoCalGas filed Advice Letter No. 5546 on  
20 November 12, 2019 to continue the TMA for the 2019 GRC cycle, and to reflect the  
21 Commission’s clarifications regarding the scope and purpose of the TMA as provided in the  
22 2019 GRC decision. The Commission approved the Advice Letter, without modification, on  
23 April 10, 2020.

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<sup>60</sup> D.16-06-054.

<sup>61</sup> *Id.* at Ordering Paragraph 4.

<sup>62</sup> *Id.* at 196.

<sup>63</sup> *Id.*

<sup>64</sup> D.19-09-051, at 639.

<sup>65</sup> *Id.* at 639, 648.

<sup>66</sup> *Id.* at 773, CoL 99.

1 As discussed in Advice Letter No. 5546, the TMA is a two-way tracking account, not  
2 recorded on SoCalGas's financial statements, that tracks tax-related items that are the result of  
3 changes in tax law, tax accounting, tax policy, or tax procedure. Specifically, the TMA  
4 separately tracks the revenue requirement impact of the differences between tax expenses  
5 authorized in the GRC and tax expenses incurred resulting from: (1) mandatory tax law changes,  
6 tax accounting changes, tax procedural changes, and tax policy changes; (2) elective tax law  
7 changes, tax accounting changes, tax procedural changes, and tax policy changes; (3) other net  
8 revenue changes caused by tax law changes, tax accounting changes, tax procedural changes, and  
9 tax policy changes; (4) the completion of audits by federal and state taxing authorities; and (5)  
10 the implementation of any IRS private letter ruling regarding compliance with IRS normalization  
11 regulations.

12 In addition, in the 2019 GRC Decision, the Commission specifically authorized  
13 SoCalGas to track in its TMA the following items, which are included within the categories  
14 listed above: (1) revenue requirement differences between including and excluding cost of  
15 removal from the ARAM calculation in the event that the IRS issues a ruling or releases further  
16 guidance that is inconsistent with D.19-09-051;<sup>67</sup> (2) revenue requirement differences between  
17 applying ARAM to excess deferred taxes on unprotected assets and applying a six-year  
18 amortization period to excess deferred taxes on such assets to “ensure that the process set forth in  
19 this decision does not contravene the IRS’s normalization rules;”<sup>68</sup> and (3) any significant  
20 changes as a result of further guidelines provided by the IRS that necessitates an adjustment to  
21 the revenue requirements.<sup>69</sup>

22 Consistent with D.19-09-051, SoCalGas is tracking and will continue to track the items in  
23 the TMA in accordance with the provisions of Advice Letter No. 5546 until such time that the  
24 Commission closes the account.

## 25 **2. Cumulative TMA Balances as of December 31, 2021**

26 Based on the foregoing and in accordance with D.19-09-051, SoCalGas presents the  
27 cumulative TMA balances as of December 31, 2021. A schedule that shows the cumulative

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<sup>67</sup> *Id.* at 638.

<sup>68</sup> *Id.* at 639.

<sup>69</sup> *Id.*

1 TMA balances (TMA Schedule) is attached as Appendix B. Consistent with the CPUC's  
2 clarifications regarding the purpose and scope of the TMA as articulated in D.19-09-051, the  
3 TMA Schedule reflects the impact of differences between authorized and incurred amounts  
4 related to changes in tax law, tax accounting, tax procedure, or tax policy, holding all other  
5 authorized items constant. As a general rule, only items and amounts that have been reported on  
6 an originally filed or amended tax return are included in the TMA Schedule, because the tax  
7 impacts have not been incurred until they are reflected in a filed tax return. Yet, to provide  
8 additional transparency to the CPUC, SoCalGas is also including in its TMA Schedule: (1) tax  
9 items and amounts that SoCalGas intends to include in amended returns to be filed after the 2024  
10 TY GRC Application is filed; and (2) 2021 items and amounts that SoCalGas intends to include  
11 in its yet-to-be-filed 2021 federal and California income tax returns.<sup>70</sup>

12 If the change in tax expense would decrease revenue, the amount is shown as a credit in  
13 the TMA Schedule. If the change in tax expense would increase revenue, the amount is shown  
14 as a debit in the TMA Schedule. As of December 31, 2021, the total, cumulative revenue impact  
15 of the tracked items shown in the TMA Schedule is a debit balance of \$35.316 million.<sup>71</sup> Each  
16 line item in the TMA Schedule is discussed in turn, below.

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<sup>70</sup> SoCalGas 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.

<sup>71</sup> In SoCalGas's 2016 GRC Decision, the Commission directed SoCalGas 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 the 2019 GRC Decision, the Commission allowed SoCalGas to track the revenue requirement difference in its TMA between including and excluding cost of removal from the ARAM calculation. In addition, SoCalGas 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 SoCalGas files its 2021 tax returns and files amended returns for prior years, SoCalGas 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                                   **b. Elective Changes in Tax Law, Tax Accounting, Tax**  
2                                   **Procedures, or Tax Policy**

3                   Alternative Fuel Refueling Property Credit

4                   IRC § 30C allows a tax credit equal to 30 percent of the cost of any qualified alternative  
5 fuel vehicle refueling property placed into service during the year.<sup>78</sup> The credit is limited to  
6 \$30,000 per location per year.<sup>79</sup> The Section 30C credit had expired at the end of the 2017 tax  
7 year. However, in December 2019, Congress retroactively reinstated the credit for the 2018-  
8 2019 tax years and prospectively extended the credit for property installed on or before  
9 December 31, 2020.<sup>80</sup> Congress again extended the Section 30C credit in 2020 to apply to  
10 property installed on or before December 31, 2021.<sup>81</sup>

11                   SoCalGas installed refueling stations for natural gas vehicles during 2018 – 2021 that  
12 qualify for the reinstated Section 30C credit. The revenue impact of the reinstated Section 30C  
13 credit for 2018 – 2021 is reflected in the TMA Schedule.<sup>82</sup>

14                                   **c. Other Net Revenue Changes**

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

17                                   **d. Completion of Audits**

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

19                                   **e. IRS Rulings on Normalization Issues**

20                   Private Letter Ruling Request – ARAM Computation

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

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<sup>78</sup> IRC § 30C(a).

<sup>79</sup> *Id.* at § 30C(b)(1).

<sup>80</sup> P.L. 116-94, div. A, title I, Sec. 125(a).

<sup>81</sup> *Id.* at 116-260, Sec. 143(a); IRC § 30C(g).

<sup>82</sup> The IRC § 30C credit for 2018 has yet to be included on a filed tax return, but SoCalGas intends to include the credit on an amended return for 2018.

1 As noted, the IRS issued its Private Letter Ruling to SoCalGas on May 1, 2022.<sup>83</sup> The  
2 IRS determined in its ruling that the CPUC's ARAM methodology that SoCalGas is following as  
3 ordered in D.19-09-051 is inconsistent with the normalization rules, while SoCalGas's proposed  
4 methodology is consistent with the normalization rules. Accordingly, SoCalGas will seek  
5 recovery of the revenue requirement difference between the two methods by filing a Tier 2  
6 advice letter, as directed by the Commission. Until SoCalGas files and receives Commission  
7 approval for its forthcoming Tier 2 advice letter, SoCalGas will continue tracking the revenue  
8 requirement difference between including and excluding cost of removal from the ARAM  
9 calculation in its TMA Schedule, as directed by the Commission.

### 10 **3. TMA Proposal for the 2024 GRC Cycle**

11 SoCalGas proposes to continue the TMA for the 2024 TY GRC cycle, including the post-  
12 test-year period, under rules and scope set forth in D.19-09-051 and Advice Letter No. 5546. In  
13 addition, SoCalGas recommends that the CPUC continue to review the TMA results in each  
14 subsequent GRC cycle.

### 15 **V. CONCLUSION**

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

20 This concludes my prepared direct testimony.

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<sup>83</sup> PLR-122708-21.

1 **VI. WITNESS QUALIFICATIONS**

2 My name is Ragan G. Reeves. I am employed by Sempra Energy, SoCalGas'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 SoCalGas 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 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**

ACRS:	Accelerated Cost Recovery System
ADFIT:	Accumulated Deferred Federal Income Tax
ADR:	Asset Depreciation Range
AFUDC:	Allowance For Funds Used During Construction
ARAM:	Average Rate Assumption Method
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
FICA:	Federal Insurance Contributions Act
FUTA:	Federal Unemployment Tax Act
GRC:	General Rate Case
HCLD:	historical cost less depreciation
HI:	Hospital Insurance ( <i>i.e.</i> , Medicare)
IRC:	Internal Revenue Code
IRS:	Internal Revenue Service
ITC:	Investment Tax Credit
ITCC:	Income Tax Component of CIAC
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
Pacific Lighting:	Pacific Lighting Gas Supply 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**

SoCalGas					
Tax Memorandum Account Tracking Schedule					
For the Tax Years Ended December 31, 2016 - 2021					
(\$ amounts in thousands)					
	Revenue Impact of Incurred Amount <sup>1</sup>	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
<b>1) Mandatory Changes in Tax Law, Tax Accounting, Tax Procedures, or Tax Policy</b>					
Beginning Balances 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	(16,514)	(16,476)	(38)	[b]	
2018 Rate Base Impact of Basis Adjustments for 2018 Bonus Depreciation on Assets Acquired Pre 9/28/17, Per the TCJA	(969)	-	(969)	[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	(1,335)	-	(1,335)	[d]	
2020 Rate Base Impact of Basis Adjustments for 2020 & Prior Bonus Depreciation on Assets Acquired Pre 9/28/17, Per the TCJA	(1,181)	-	(1,181)	[e]	
2021 Rate Base Impact of Basis Adjustments for 2020 & Prior Bonus Depreciation on Assets Acquired Pre 9/28/17, Per the TCJA	(989)	-	(989)	[f]	To be included on 2021 tax return to be filed
Revenue Impact of Differences as of 12/31/2021			(4,511)	[g] = [a] + [b] + [c] + [d] + [e] + [f]	
<b>2) Elective Changes in Tax Law, Tax Accounting, Tax Procedures, or Tax Policy</b>					
Beginning Balances from 2016 TMA			-	[h]	
2018 Alternative Fuel 30C Credit	(248)	-	(248)	[i]	To be included on 2018 amended tax return to be filed
2019 Alternative Fuel 30C Credit	(292)	-	(292)	[j]	
2020 Alternative Fuel 30C Credit	(72)	-	(72)	[k]	
2021 Alternative Fuel 30C Credit	(157)	-	(157)	[l]	To be included on 2021 tax return to be filed
Revenue Impact of Differences as of 12/31/2021			(768)	[m] = [h] + [i] + [j] + [k] + [l]	
<b>3) Other Net Revenue Changes</b>					
None			-	[n]	
<b>4) Adjustments due to Completion of Audits</b>					
None			-	[o]	
<b>5) Adjustments due to IRS Private Letter Rulings on Normalization Issues</b>					
2018 Impact of Including Book Accruals for COR in ARAM Amortization	(15,519)	(26,627)	11,108	[p]	To be addressed through Tier 2 Advice Letter to be filed
2018 Rate Base Impact of 2018 ARAM Amortization Adjustment	(754)	-	(754)	[q]	To be addressed through Tier 2 Advice Letter to be filed
2019 Impact of Including Book Accruals for COR in ARAM Amortization	(16,527)	(28,810)	12,284	[r]	To be addressed through Tier 2 Advice Letter to be filed
2019 Rate Base Impact of 2018 - 2019 ARAM Amortization Adjustments	(1,588)	-	(1,588)	[s]	To be addressed through Tier 2 Advice Letter to be filed
2020 Impact of Including Book Accruals for COR in ARAM Amortization	(16,527)	(28,810)	12,284	[t]	To be addressed through Tier 2 Advice Letter to be filed
2020 Rate Base Impact of 2018 - 2020 ARAM Amortization Adjustments	(2,418)	-	(2,418)	[u]	To be addressed through Tier 2 Advice Letter to be filed
2021 Impact of Including Book Accruals for COR in ARAM Amortization	(16,527)	(28,810)	12,284	[v]	To be addressed through Tier 2 Advice Letter to be filed
2021 Rate Base Impact of 2018 - 2021 ARAM Amortization Adjustments	(3,249)	-	(3,249)	[w]	To be addressed through Tier 2 Advice Letter to be filed
Revenue Impact of Differences as of 12/31/2021			39,949	[x] = [p] + [q] + [r] + [s] + [t] + [u] + [v] + [w]	
<b>Total Revenue Impact of Differences/Changes 12/31/2021</b>			34,670	[y] = [g] + [m] + [n] + [o] + [x]	
Cumulative Interest (Payable)/Receivable as of 12/31/2021			646	[z]	
<b>Ending Cumulative Balance (Credit)/Debit as of 12/31/2021</b>			<b>35,316</b>	[aa] = [y] + [z]	
<b>NOTES:</b>					
<sup>1</sup> Incurred amounts are subject to change until the income tax returns are filed and the federal and state audits are completed.					

**SoCalGas 2024 GRC Testimony Revision Log –November 2022**

<b>Exhibit</b>	<b>Witness</b>	<b>Page</b>	<b>Line or Table</b>	<b>Revision Detail</b>
SCG-33-R	Ragan G. Reeves	RGR-iii	2 <sup>nd</sup> bullet point	Changed ad valorem tax expense from “\$166.1 million” to “\$167.0 million”; Changed income tax expense from “\$194.4 million” to “\$194.2 million”
SCG-33-R	Ragan G. Reeves	RGR-6	Table SCG-RR-2	Revised table
SCG-33-R	Ragan G. Reeves	RGR-22	Table SCG-RR-3-1	Revised table
SCG-33-R	Ragan G. Reeves	RGR-23	Table SCG-RR-3-2	Revised table