STATE OF CALIFORNIA | Edmund G. Brown Jr., *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

April 9, 2015

Advice Letter 4777-G

Rasha Prince, Director
Regulatory Affairs
Southern California Gas
555 W. Fifth Street, GT14D6
Los Angeles, CA 90013-1011

SUBJECT: Revision to SoCal Gas' 2012-2015 GRC Revenue Requirements (D.13-05-010) in Compliance with Section 19.1.1 (Tax Relief Act)

Dear Ms. Prince:

Advice Letter 4777-G is effective as of April 10, 2015.

Sincerely,

Edward Randolph

Edward Randolph
Director, Energy Division

Rasha Prince
Director
Regulatory Affairs

555 W. Fifth Street, GT14D6
Los Angeles, CA 90013-1011
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Fax: 213.244.4957
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March 11, 2015

Advice No. 4777
(U 904 G)

Public Utilities Commission of the State of California

Subject: **Revision to SoCalGas' 2012-2015 General Rate Case Revenue Requirements (D.13-05-010) in Compliance with Section 19.1.1 (Tax Relief Act)**

In compliance with Section 19.1.1., Effects of Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRA), Southern California Gas Company (SoCalGas) hereby submits revisions to its Preliminary Statements, applicable throughout its service territory, as shown on Attachment A.

Purpose

This revises SoCalGas' 2012 through 2015 California Public Utilities Commission (Commission) authorized General Rate Case (GRC) revenue requirement to comply with the normalization requirements of Internal Revenue Code Section 168(i)(9), as interpreted by the Internal Revenue Service (IRS) in Private Letter Ruling (PLR) 136851-14 and shown in Attachment B. In Decision (D.) 13-05-010, the Commission stated its intent to comply with a normalization method of accounting[1], however, the IRS has ruled that D.13-05-010 violated the tax normalization rules by excluding the NOL-based deferred tax asset from ratebase. A violation of the tax normalization rules must be corrected to prevent the loss of favorable tax benefits associated with accelerated tax depreciation. This advice letter adjusts the revenue requirement arising from the accumulated deferred income tax (ADIT) balances attributable to the net operating loss carry-forward amount (NOLCF/ADIT).[2] Consistent with Ordering Paragraph 29 of D.13-05-010, SoCalGas requested and received a private letter ruling from the IRS and is filing this advice letter to comply with the IRS' interpretation of the applicable tax laws.

Background

In July 2011, SoCalGas updated its testimony in the 2012 GRC (Application 10-12-006) to reflect the impact of the TRA signed into law by President Obama in December 2010. Section

[1] D.13-05-101 at page 952.
[2] This adjustment to reduce the ADIT liability balance for the NOLCF/ADIT is consistent with the tax normalization requirements of the Internal Revenue Code as concluded in PLR 136851-14.

401 of the TRA amended the tax depreciation portion of the tax code (i.e., Internal Revenue Code Section 168(k)) to extend the temporary bonus depreciation provisions through tax year 2012, as shown on Attachment C.

The TRA's extension of bonus tax depreciation resulted in significant additional tax depreciation deductions for the 2010-2012 tax years. These additional tax depreciation deductions created net Federal income tax losses (i.e., net operating losses). Ordinarily, ADIT is computed as the difference between book and tax depreciation times the applicable tax rate. However, due to the size of the tax depreciation deductions, SoCalGas was not able to utilize all of those deductions in computing the test year 2012 revenue requirement. Therefore, the computation of ADIT should have been based on the difference between book depreciation and the amount of tax depreciation that could be utilized in 2012. SoCalGas' GRC revenue requirement determination accounted for this in a two-step process: (1) compute the ADIT as if the full amount of tax depreciation deductions could be claimed; and (2) offset that amount by the ADIT associated with the NOL amount.

D.13-05-010, Section 20.4.3.3 on page 952 states:

> Thus, it is reasonable to allow SDG&E and SoCalGas to apply bonus depreciation to current tax expenses, and to allow SoCalGas to delay recording unused deferred tax liabilities against ratebase until they are used. However, it is unreasonable for SoCalGas ratepayers to provide a rate of return on a deferred tax asset based on a NOL. As a result, the Results of Operations in Attachment B excludes any NOL-based deferred asset from ratebase. To the extent applicable, SDG&E and SoCalGas may file Tier 1 advice letters to create memorandum accounts to track any NOL that may arise due to bonus depreciation, and either utility may file a Tier 2 advice letter seeking an adjustment to its revenue requirement if an IRS ruling supporting such an adjustment is obtained.

On October 1, 2014, SoCalGas submitted a private letter ruling to the IRS, as shown on Attachment D, requesting the IRS to rule on the following:

1. Whether the reduction to rate base by the full amount of the ADIT balance unreduced by the balance of the NOLCF/ADIT would be inconsistent with (and, hence, a violation of) the normalization requirements of Internal Revenue Code Section 168(i)(9) and Section 1.167(l)-1 of the Income Tax Regulations.

2. For purposes of Ruling 1 above, whether the use of a balance of the NOLCF/ADIT that is less than the amount attributable to bonus depreciation computed on a "with and without" basis would be inconsistent with (and, hence, a violation of) the requirements of Internal Revenue Code Section 168(i)(9) and Section 1.167(l)-1 of the Income Tax Regulations.

3. Whether the assignment of a zero rate of return to the balance of the NOLCF/ADIT would be inconsistent with (and, hence, a violation of) the requirements of Internal

Revenue Code Section 168(i)(9) and Section 1.167(l)-1 of the Income Tax Regulations.

On February 4, 2015, the IRS issued its private letter ruling to SoCalGas in response to SoCalGas' October 1, 2014 ruling request. In PLR 136851-14, the IRS ruled as follows:

1. The reduction of SoCalGas' rate base by the full amount of its ADIT balance unreduced by the balance of its NOLCF/ADIT would be inconsistent with the requirements of Internal Revenue Code Section 168(i)(9) and Section 1.167(l)-1 of the Income Tax Regulations.

2. For purposes of Ruling 1 above, the use of a balance of SoCalGas' NOLCF/ADIT that is less than the amount attributable to bonus depreciation computed on a "with and without" basis would be inconsistent with (and, hence, a violation of) the requirements of Internal Revenue Code Section 168(i)(9) and Section 1.167(l)-1 of the Income Tax Regulations.

3. The assignment of a zero rate of return to the balance of SoCalGas' NOLCF/ADIT asset would be inconsistent with (and, hence, a violation of) the requirements of Internal Revenue Code Section 168(i)(9) and Section 1.167(l)-1 of the Income Tax Regulations.

Therefore, in compliance with Section 20.4.3.3 and Ordering Paragraph 29 of D.13-05-010, and the IRS' interpretation of the applicable federal income tax laws and regulations, SoCalGas submits this Tier 2 advice letter to revise its revenue requirement. This advice letter is similar to the one that Southern California Edison Company (SCE) had filed and obtained Commission approval to adjust their GRC revenue requirement upon receipt of the PLR from the IRS. [3] The inclusion of the deferred tax asset resulting from a taxable net operating loss in determining authorized ratebase is also consistent with the treatment adopted by the Federal Energy Regulatory Commission (FERC) in previous FERC filings and decisions on SDG&E's electric transmission revenue requirement.

SoCalGas' Updated 2012 Through 2015 Commission-Authorized GRC Revenue Requirements

SoCalGas' revised 2012 through 2015 CPUC authorized base revenue requirement is calculated based on Commission adopted rate of return percentages applicable for those years. Table 1 below shows the revised revenue requirements, as compared to the currently authorized revenue requirements.

[3] SCE Advice 3092-E filed on August 14, 2014 and approved by the Commission on November 21, 2014.

Table 1
Base Margin Changes
$ in thousands

Line No.		2012	2013[2]	2014	2015
1	Authorized Escalation %[1]		2.65%	2.75%	2.75%
2	Current Authorized Base Margin	1,855,615	1,879,358	1,931,040	1,984,144
3	Revised Base Margin	1,862,050	1,885,605	1,937,459	1,990,739
4	Increase/(Decrease)	6,435	6,247	6,418	6,595

Notes:
[1]D.13.05.010, Ordering Paragraph 4 , adopted attrition increases of 2.65% in 2013 and 2.75% in 2014 and 2015.
[2]2013 includes a Cost of Capital (CoC) adjustment of ($25,431K) as filed in Advice Letter 4496.

Table 2 shows the components of SoCalGas' revised CPUC authorized revenue requirement as a result of including the NOLCF for its test year 2012.

Table 2
Results of Operations
2012 Authorized vs. 2012 Revised
$ in thousands

Line No.		2012 Authorized	2012 Revised	Change
1	Base Margin	1,855,615	1,862,050	6,435
2	Misc Revenues	103,131	103,131	-
3	Revenue Requirement	1,958,745	1,965,180	6,435
4	Expenses:			
5	Operation & Maintenance	1,088,419	1,088,530	111
6	Depreciation	364,520	364,520	-
7	Taxes	206,879	208,980	2,101
8	Total Expenses	1,659,818	1,662,030	2,212
9	Return	298,927	303,150	4,223
10	Ratebase	3,443,860	3,492,515	48,655
11	Rate of Return	8.68%	8.68%	0%

Table 3 below shows the incremental change in the adopted 2012 Test Year GRC revenue requirement for SoCalGas' Attrition Years 2013 through 2015, which is based on the attrition mechanism adopted in the 2012 GRC as well as SoCalGas' 2013 Cost of Capital.

Table 3
Incremental Base Margin
2012 Test Year and 2013-2015 Attrition Years
$ in thousands

Line No.		2012	2013	2014	2015
1	Authorized Escalation %[1]		2.65%	2.75%	2.75%
2	2012 Rev Req Increase	6,435	6,435	6,435	6,435
3	2013 AY Increase		171	171	171
4	2013 Cost of Capital Adjustment[2]		(359)	(359)	(359)
5	2014 AY Increase			172	172
6	2015 AY Increase				177
	Total	6,435	6,247	6,418	6,595

Notes:

[1]D.13.05.010, Ordering Paragraph 4 , adopted attrition increases of 2.65% in 2013 and 2.75% in 2014 and 2015.

[2]D.12.12.034, Ordering Paragraph 3, adopted a 2013 cost of capital structure that changed the weighted return on ratebase from 8.68% to 8.02%

SoCalGas will record the increase in revenue requirements for years 2012 through 2014, and January 2015 through the effective date of this advice letter in SoCalGas' applicable fixed cost balancing accounts (i.e., Core Fixed Cost Account – CFCA; and Noncore Fixed Cost Account - NFCA). SoCalGas will be using the revised 2015 revenue requirement in the operation of the CFCA and NFCA once this advice letter becomes effective. The adjustment for the change in revenue requirement will be included in the CFCA and NFCA under (over) collection balance in connection with SoCalGas' annual regulatory account balance update filing for consolidation in 2016 rates upon Commission approval.

Proposed Tariff Changes

This advice letter filing revises the existing regulatory mechanisms to reflect the revised Authorized Base Revenue Requirements (ABRR) for 2012 through 2015.

- Preliminary Statement, Part V, Balancing Accounts

- Core Fixed Cost Account
- Noncore Fixed Cost Account

This advice filing will not increase any rate or charge, cause the withdrawal of service, or conflict with any other schedule or rule.

Protest

Anyone may protest this Advice Letter to the Commission. The protest must state the grounds upon which it is based, including such items as financial and service impact, and should be submitted expeditiously. The protest must be made in writing and received within 20 days of the date of this Advice Letter which is March 31, 2015. There is no restriction on who may file a protest. The address for mailing or delivering a protest to the Commission is:

CPUC Energy Division
Attention: Tariff Unit
505 Van Ness Avenue
San Francisco, CA 94102

Copies of the protest should also be sent via e-mail to the attention of the Energy Division Tariff Unit (EDTariffUnit@cpuc.ca.gov). A copy of the protest shall also be sent via both e-mail and facsimile to the address shown below on the same date it is mailed or delivered to the Commission.

Attn: Sid Newsom
Tariff Manager - GT14D6
555 West Fifth Street
Los Angeles, CA 90013-1011
Facsimile No.: (213) 244-4957
E-Mail: snewsom@semprautilities.com

Effective Date

SoCalGas believes this Advice Letter is subject to Energy Division disposition and should be classified as Tier 2 (effective after staff approval) pursuant to General Order (GO) 96-B. Therefore, SoCalGas respectfully requests that it be made effective on April 10, 2015, which is 30 days after the date of filing.

Notice

A copy of this advice letter is being sent to SoCalGas' GO 96-B service list and the Commission's service list for A.10-12-006, SoCalGas' TY 2013 GRC. Address change requests to the GO 96-B should be directed by electronic mail to tariffs@socalgas.com or call 213-244-3387. For changes to all other service lists, please contact the Commission's Process Office at 415-703-2021 or by electronic mail at process_office@cpuc.ca.gov.

____
Rasha Prince
Director – Regulatory Affairs

Attachments

CALIFORNIA PUBLIC UTILITIES COMMISSION

ADVICE LETTER FILING SUMMARY
ENERGY UTILITY

MUST BE COMPLETED BY UTILITY (Attach additional pages as needed)

Company name/CPUC Utility No. **SOUTHERN CALIFORNIA GAS COMPANY (U 904G)**

Utility type:	Contact Person: Sid Newsom
☐ ELC ☒ GAS	Phone #: (213) 244-2846
☐ PLC ☐ HEAT ☐ WATER	E-mail: SNewsom@semprautilities.com

EXPLANATION OF UTILITY TYPE	(Date Filed/ Received Stamp by CPUC)
ELC = Electric GAS = Gas PLC = Pipeline HEAT = Heat WATER = Water	

Advice Letter (AL) #: 4777

Subject of AL: Revision to SoCalGas' 2012-2015 GRC Revenue Requirements (D.13-05-010) in Compliance with Section 19.1.1 (Tax Relief Act)

Keywords (choose from CPUC listing): Taxes; GRC

AL filing type: ☐ Monthly ☐ Quarterly ☐ Annual ☒ One-Time ☐ Other

If AL filed in compliance with a Commission order, indicate relevant Decision/Resolution #:

D.13-05-010

Does AL replace a withdrawn or rejected AL? If so, identify the prior AL No

Summarize differences between the AL and the prior withdrawn or rejected AL[1]: N/A

Does AL request confidential treatment? If so, provide explanation: No

Resolution Required? ☐ Yes ☒ No Tier Designation: ☐ 1 ☒ 2 ☐ 3

Requested effective date: 4/10/15 No. of tariff sheets: 6

Estimated system annual revenue effect: (%): N/A

Estimated system average rate effect (%): N/A

When rates are affected by AL, include attachment in AL showing average rate effects on customer classes (residential, small commercial, large C/I, agricultural, lighting).

Tariff schedules affected: PS Part V, CFCA, NFCA and TOCs

Service affected and changes proposed[1]: N/A

Pending advice letters that revise the same tariff sheets: None

Protests and all other correspondence regarding this AL are due no later than 20 days after the date of this filing, unless otherwise authorized by the Commission, and shall be sent to:

CPUC, Energy Division	**Southern California Gas Company**
Attention: Tariff Unit	**Attention: Sid Newsom**
505 Van Ness Ave.,	**555 West 5th Street, GT14D6**
San Francisco, CA 94102	**Los Angeles, CA 90013-1011**
EDTariffUnit@cpuc.ca.gov	**SNewsom@semprautilities.com**
	Tariffs@SoCalGas.com

[1] Discuss in AL if more space is needed.

ATTACHMENT A
Advice No. 4777

Cal. P.U.C. Sheet No.	Title of Sheet	Cancelling Cal. P.U.C. Sheet No.
Revised 51352-G	PRELIMINARY STATEMENT - PART V - BALANCING ACCOUNTS, CORE FIXED COST ACCOUNT (CFCA), Sheet 1	Revised 50449-G
Revised 51353-G	PRELIMINARY STATEMENT - PART V - BALANCING ACCOUNTS, CORE FIXED COST ACCOUNT (CFCA), Sheet 2	Revised 50449-G Revised 49710-G
Revised 51354-G	PRELIMINARY STATEMENT - PART V - BALANCING ACCOUNTS, NONCORE FIXED COST ACCOUNT (NFCA), Sheet 1	Revised 49711-G
Revised 51355-G	PRELIMINARY STATEMENT - PART V - BALANCING ACCOUNTS, NONCORE FIXED COST ACCOUNT (NFCA), Sheet 2	Revised 49711-G Revised 49308-G
Revised 51356-G	PRELIMINARY STATEMENT - PART V - BALANCING ACCOUNTS, NONCORE FIXED COST ACCOUNT (NFCA), Sheet 3	Revised 49308-G
Revised 51357-G	TABLE OF CONTENTS	Revised 51351-G

PRELIMINARY STATEMENT - PART V - BALANCING ACCOUNTS

CORE FIXED COST ACCOUNT (CFCA)

1. Purpose

The CFCA is an interest bearing balancing account recorded on SoCalGas' financial statements. The purpose of this account is to balance the difference between the authorized margin, (excluding the transmission revenue requirements and Backbone Transportation Service (BTS) revenue requirement) and other non-gas costs as detailed below, including funding of SoCalGas' Gas Assistance Fund (GAF) program pursuant to Advice No. 4168, and storage costs associated with the allocation of storage adopted in D.08-12-020 that are not currently reflected in current rates, allocated to the core market with revenues intended to recover these costs. Pursuant to Advice No. 3963, SoCalGas establishes a separate subaccount in the CFCA to track authorized funding by the CPUC and related funds actually used in providing eligible customers with assistance in paying their bills in connection with SoCalGas' Gas Assistance Fund (GAF) program.

In accordance with Advice No. 4177-A, filed pursuant to D.07-08-029, D.10-09-001, and Resolution G-3489, the CFCA will be credited for the core's allocation of the System Modification Fee (SMF) charged to California Producers to offset the system modification costs which have been incorporated in base rates in connection with SoCalGas' 2012 General Rate Case.

In accordance with Advice No. 4772 filed pursuant to D.13-05-010, the CFCA will be debited for the core's allocation of the revenue requirement adjustments to comply with the normalization requirements of Internal Revenue Code Section 168(i)(9), as interpreted by the Internal Revenue Service in Private Letter Ruling (PLR) 136851-14. These revenue requirement adjustments are associated with SoCalGas' net operating loss carry-forward amounts that should have been used to reduce SoCalGas' accumulated deferred income tax liability balance in determining SoCalGas' authorized rate base in connection with SoCalGas' 2012 General Rate Case. N

2. Applicability

The CFCA shall apply to all core gas customers.

3. Rates

The projected year-end CFCA balance will be applied to core gas transportation rates.

4. Accounting Procedures

SoCalGas shall maintain the CFCA by recording entries at the end of each month, net of FF&U, as follows:

a. A debit entry equal to seasonalized monthly amount of the authorized margin;
b. A one-time debit entry equal to the adjustment to the adopted revenue requirements for Test Year 2012 and Attrition Years 2013 through 2014 to comply with the normalization requirements pursuant to PLR 136851-14; N N L

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PRELIMINARY STATEMENT - PART V - BALANCING ACCOUNTS Sheet 2
CORE FIXED COST ACCOUNT (CFCA)

(Continued)

4. Accounting Procedures (Continued)

c. A debit entry equal to the adjustment to the adopted revenue requirements for Attrition Year 2015, prorated on a seasonalized basis during the year, to comply with the normalization requirements pursuant to PLR 136851-14; N | N
d. A debit entry equal to the recorded cost of the core portion of company-use fuel (excluding transmission and load balancing company-use fuel); T, L |
e. A debit entry equal to the recorded cost for the core portion of unaccounted for gas; |
f. A debit entry equal to the recorded cost for the core portion of well incidents and surface leaks; |
g. A debit entry equal to the actual funds used, up to amounts authorized by the Commission, in providing eligible customers with assistance in paying their bills in connection with SoCalGas' Gas Assistance Fund (GAF) program; | | |
h. An adjustment to reflect storage costs consistent with the allocation of storage adopted in D.08-12-020 that are not currently reflected in current transportation rates; T,L L
i. A credit entry equal to the core portion of the following recorded revenues: transportation revenues from core deliveries; revenues from the sale of core storage capacity rights; base revenues that would have been collected from customers absent the core pricing flexibility program, and other revenues that the Commission has directed SoCalGas to allocate to the core market; T
j. An entry to amortize the previous year's balance; T
k. A credit entry equal to the core's allocation of the SMF charged to California Producers; and T
l. An entry equal to interest on the average balance in the account during the month, calculated in the manner described in Preliminary Statement, Part I, J. T

SoCalGas shall maintain the GAF subaccount by recording entries at the end of each month, net of FF&U, as follows:

a. A debit entry equal to actual funds provided to customers for paying their gas bills;
b. A credit entry equal to funds to be used in providing customers with assistance in paying their gas bills; and
c. An entry equal to interest on the average balance in the subaccount during the month, calculated in the manner described in Preliminary Statement, Part I. J.

5. Disposition

In each annual October regulatory account balance update filing, SoCalGas will amortize the projected year-end CFCA balance effective January 1 of the following year. The projected year-end balance will be allocated on an Equal Cents Per Therm (ECPT) basis.

For the GAF subaccount, the disposition of any unspent funds will be addressed in SoCalGas' next annual regulatory account update filing or other appropriate filing.

PRELIMINARY STATEMENT - PART V - BALANCING ACCOUNTS Sheet 1

NONCORE FIXED COST ACCOUNT (NFCA)

1. Purpose

The NFCA is an interest-bearing balancing account recorded on SoCalGas' financial statements. The purpose of this account is to balance the difference between the authorized margin (excluding the transmission revenue requirement and Backbone Transportation Service (BTS) revenue requirement) and other non-gas costs as detailed below associated with the noncore market, including funding of SoCalGas' Gas Assistance Fund (GAF) program pursuant to Advice No. 4168 with noncore revenues intended to recover these costs. The noncore market excludes the Unbundled Storage Program. Pursuant to the BCAP Decision 09-11-006, the Commission authorized the NFCA 100% balancing account treatment (i.e., balancing of 100% of noncore costs and revenues).

In accordance with Advice No. 4177-A, filed pursuant to D.07-08-029, D.10-09-001, and Resolution G-3489, the NFCA will be credited for the noncore's allocation (excluding Enhanced Oil Recovery) of the System Modification Fee (SMF) charged to California Producers to offset the system modification costs which have been incorporated in base rates in connection with SoCalGas' 2012 General Rate Case.

The NFCA shall be divided into two subaccounts: a) authorized base margin and b) non-base margin costs and revenues.

In accordance with Advice No. 4772 filed pursuant to D.13-05-010, the CFCA will be debited for the noncore's allocation of the revenue requirement adjustments to comply with the normalization requirements of Internal Revenue Code Section 168(i)(9), as interpreted by the Internal Revenue Service in Private Letter Ruling (PLR) 136851-14. These revenue requirement adjustments are associated with SoCalGas' net operating loss carry-forward amounts that should have been used to reduce SoCalGas' accumulated deferred income tax liability balance in determining SoCalGas' authorized rate base in connection with SoCalGas' 2012 General Rate Case. N

2. Applicability

The NFCA shall apply to all noncore gas customers excluding EOR.

3. Rates

The projected year-end NFCA balance will be applied to noncore gas transportation rates.

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4. Accounting Procedures – Authorized Base Margin Subaccount

SoCalGas shall maintain this subaccount by recording entries at the end of each month, net of FF&U, as follows:

a. A debit entry equal to the seasonalized monthly amount of the authorized margin;
b. A one-time debit entry equal to the adjustment to the adopted revenue requirements for Test Year 2012 and Attrition Years 2013 through 2014 to comply with the normalization requirements pursuant to PLR 136851-14;
c. A debit entry equal to the adjustment to the adopted revenue requirements for Attrition Year 2015, prorated on a seasonalized basis during the year, to comply with the normalization requirements pursuant to PLR 136851-14;
d. A credit entry equal to the noncore revenues to recover the authorized margin excluding revenues from (1) future non-tariff contracts with Sempra Energy affiliates not subject to competitive bidding and (2) Competitive Load Growth Opportunities for noncore Rule No. 38 and Red Team incentive revenues;
e. An entry to amortize the previous year's balance;
f. A credit entry equal to the noncore's allocation of the SMF charged to California Producers; and
g. An entry equal to interest on the average balance in the subaccount during the month, calculated in the manner described in Preliminary Statement, Part I, J.

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5. Accounting Procedures – Non-Base Margin Costs and Revenues Subaccount

SoCalGas shall maintain this subaccount by recording entries at the end of each month, net of FF&U, as follows:

a. A debit entry equal to the recorded cost for the noncore portion of company-use fuel (excluding transmission and load balancing company-use fuel);
b. A debit entry equal to the recorded cost for the noncore portion of unaccounted for gas;
c. A debit entry equal to the recorded cost for the noncore portion of well incidents and surface leaks;
d. A debit entry equal to the actual funds used, up to amounts authorized by the Commission, in providing eligible customers with assistance in paying their bills in connection with SoCalGas' Gas Assistance Fund (GAF) program;
e. A credit entry equal to the noncore revenues to recover the costs associated with this subaccount;
f. A credit entry equal to 100% of the net revenues associated with the Utility System Operator providing transportation imbalance services under Schedule No. G-IMB to the Utility Gas Acquisition Department;
g. An entry to amortize the previous year's balance; and
h. An entry equal to interest on the average balance in the subaccount during the month, calculated in the manner described in Preliminary Statement, Part I, J.

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(Continued)

6. Disposition

In each annual October regulatory account balance update filing, SoCalGas will amortize the projected year-end balance effective January 1 of the following year. For the first year subsequent to the BCAP decision, both the Authorized Base Margin Subaccount and Non-Base Margin Costs and Revenues Subaccount will be allocated on an Equal Cents Per Therm (ECPT) basis. Starting in the second year subsequent to the BCAP decision, the Authorized Base Margin Subaccount will be allocated on an Equal Percent of Authorized Margin (EPAM) basis. The Non-Base Margin Costs and Revenues Subaccount will continue to be allocated on an ECPT basis.

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ATTACHMENT B

Advice No. 4777

Internal Revenue Service
Private Letter Ruling
136851-14

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Index Number: 167.22-01

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B06
PLR-136851-14
Date: FEB 04 2015

LEGEND:

Taxpayer =

Parent =

State A =
Commission =
Year A =
Year B =
Year C =
Year D =
Date A =
Date B =
Date C =
Date D =
Case =
Director =

Dear :

This letter responds to the request, dated October 1, 2014, submitted on behalf of Taxpayer for a ruling on the application of the normalization rules of the Internal Revenue Code to certain accounting and regulatory procedures, described below.

The representations set out in your letter follow.

Taxpayer is a regulated, investor-owned public utility incorporated under the laws of State A primarily engaged in the business of supplying natural gas service in State A. Taxpayer is subject to the regulatory jurisdiction of Commission with respect to terms

and conditions of service and as to the rates it may charge for the provision of service. Taxpayer's rates are established on a cost of service basis.

Taxpayer is wholly owned by Parent, and Taxpayer is included in a consolidated federal income tax return of which Parent is the common parent. Taxpayer employs the accrual method of accounting and reports on a calendar year basis.

Taxpayer filed a rate case application on Date A (Case). In its filing, Taxpayer used as its starting point actual data from the historic test period, calendar Year A. It then projected data for Year B through Year D. Taxpayer updated, amended, and supplemented its data several times during the course of the proceedings. Rates in this proceeding were intended to, and did, go into effect for the period Date B through Date C.

In computing its income tax expense element of cost of service, the tax benefits attributable to accelerated depreciation were normalized and were not flowed thru to ratepayers.

In its rate case filing, Taxpayer anticipated that it would claim accelerated depreciation, including "bonus depreciation" on its tax returns to the extent that such depreciation was available in all years for which data was provided. Additionally, Taxpayer forecasted that it would incur a net operating loss (NOL) in each of Year B, Year C, and Year D. Taxpayer anticipated that it had the capacity to carry back a portion of this NOL with the remainder producing a net operating loss carryover (NOLC) as of the end of Year C and Year D, the beginning and end of the test period.

On its regulatory books of account, Taxpayer "normalizes" the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute "cost-free capital" to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries – a "deferred tax asset" and a "deferred tax expense" - that reflect that portion of those 'tax losses' which, while due to accelerated depreciation, did not actually defer tax because of the existence of an NOLC.

In the setting of utility rates in State, a utility's rate base is offset by its ADIT balance. In its rate case filing and throughout the proceeding, Taxpayer maintained that the ADIT balance should be reduced by the amounts that Taxpayer calculates did not actually defer tax due to the presence of the NOLC, as represented in the deferred tax asset account. Thus, Taxpayer argued that the rate base should be reduced as of the end of Year D by its federal ADIT balance net of the deferred tax asset account

attributable to the federal NOLC. It based this position on its determination that this net amount represented the true measure of federal income taxes deferred on account of its claiming accelerated tax depreciation deductions and, consequently, the actual quantity of "cost-free" capital available to it. It also asserted that the failure to reduce its rate base offset by the deferred tax asset attributable to the federal NOLC would be inconsistent with the normalization rules Testimony by another participant in Case argued against Taxpayer's proposed calculation of ADIT.

Commission, in an order issued on Date D, held that it is inappropriate to include the NOL in rate base for ratemaking purposes. Commission further stated that it is the intent of the Commission that Taxpayer comply with the normalization method of accounting and tax normalization regulations. Commission noted that if Taxpayer later obtains a ruling from the IRS which affirms Taxpayer's position, Taxpayer may file seeking an adjustment. Commission also held that to the extent tax normalization rules require including the NOL in rate base in the specified years, no rate of return is authorized.

Taxpayer requests that we rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with and without" basis would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
3. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would be inconsistent with (and, hence, violative of) the requirements of § 168(i)(9) and § 1.167(l)-1.

Law and Analysis

Section 168(f)(2) of the Code provides that the depreciation deduction determined under section 168 shall not apply to any public utility property (within the meaning of section 168(i)(10)) if the taxpayer does not use a normalization method of accounting.

In order to use a normalization method of accounting, section 168(i)(9)(A)(i) of the Code requires the taxpayer, in computing its tax expense for establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, to use a method of depreciation with respect to public utility property that is

the same as, and a depreciation period for such property that is not shorter than, the method and period used to compute its depreciation expense for such purposes. Under section 168(i)(9)(A)(ii), if the amount allowable as a deduction under section 168 differs from the amount that would be allowable as a deduction under section 167 using the method, period, first and last year convention, and salvage value used to compute regulated tax expense under section 168(i)(9)(A)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(i)(9)(B)(i) of the Code provides that one way the requirements of section 168(i)(9)(A) will not be satisfied is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with such requirements. Under section 168(i)(9)(B)(ii), such inconsistent procedures and adjustments include the use of an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under section 168(i)(9)(A)(ii), unless such estimate or projection is also used, for ratemaking purposes, with respect to all three of these items and with respect to the rate base.

Former section 167(l) of the Code generally provided that public utilities were entitled to use accelerated methods for depreciation if they used a "normalization method of accounting." A normalization method of accounting was defined in former section 167(l)(3)(G) in a manner consistent with that found in section 168(i)(9)(A). Section 1.167(l)-1(a)(1) of the Income Tax Regulations provides that the normalization requirements for public utility property pertain only to the deferral of federal income tax liability resulting from the use of an accelerated method of depreciation for computing the allowance for depreciation under section 167 and the use of straight-line depreciation for computing tax expense and depreciation expense for purposes of establishing cost of services and for reflecting operating results in regulated books of account. These regulations do not pertain to other book-tax timing differences with respect to state income taxes, F.I.C.A. taxes, construction costs, or any other taxes and items.

Section 1.167(l)-1(h)(1)(i) provides that the reserve established for public utility property should reflect the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes.

Section 1.167(l)-1(h)(1)(iii) provides that the amount of federal income tax liability deferred as a result of the use of different depreciation methods for tax and ratemaking purposes is the excess (computed without regard to credits) of the amount the tax liability would have been had the depreciation method for ratemaking purposes been used over the amount of the actual tax liability. This amount shall be taken into account for the taxable year in which the different methods of depreciation are used. If, however, in respect of any taxable year the use of a method of depreciation other than a subsection (1) method for purposes of determining the taxpayer's reasonable allowance under section 167(a) results in a net operating loss carryover to a year succeeding such

taxable year which would not have arisen (or an increase in such carryover which would not have arisen) had the taxpayer determined his reasonable allowance under section 167(a) using a subsection (1) method, then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

Section 1.167(l)-1(h)(2)(i) provides that the taxpayer must credit this amount of deferred taxes to a reserve for deferred taxes, a depreciation reserve, or other reserve account. This regulation further provides that, with respect to any account, the aggregate amount allocable to deferred tax under section 167(1) shall not be reduced except to reflect the amount for any taxable year by which Federal income taxes are greater by reason of the prior use of different methods of depreciation. That section also notes that the aggregate amount allocable to deferred taxes may be reduced to reflect the amount for any taxable year by which federal income taxes are greater by reason of the prior use of different methods of depreciation under section 1.167(l)-1(h)(1)(i) or to reflect asset retirements or the expiration of the period for depreciation used for determining the allowance for depreciation under section 167(a).

Section 1.167(l)-1(h)(6)(i) provides that, notwithstanding the provisions of subparagraph (1) of that paragraph, a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes under section 167(l) which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking.

Section 1.167(l)-1(h)(6)(ii) provides that, for the purpose of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (i), above, if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for that period is the amount of the reserve (determined under section 1.167(l)-1(h)(2)(i)) at the end of the historical period. If such determination is made by reference both to an historical portion and to a future portion of a period, the amount of the reserve account for the period is the amount of the reserve at the end of the historical portion of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged to the account during the future portion of the period.

Section 1.167(l)-1(h) requires that a utility must maintain a reserve reflecting the total amount of the deferral of federal income tax liability resulting from the taxpayer's use of different depreciation methods for tax and ratemaking purposes. Taxpayer has done so. Section 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the

taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Section 56(a)(1)(D) provides that, with respect to public utility property the Secretary shall prescribe the requirements of a normalization method of accounting for that section.

Regarding the first issue, § 1.167(l)-1(h)(6)(i) provides that a taxpayer does not use a normalization method of regulated accounting if, for ratemaking purposes, the amount of the reserve for deferred taxes which is excluded from the base to which the taxpayer's rate of return is applied, or which is treated as no-cost capital in those rate cases in which the rate of return is based upon the cost of capital, exceeds the amount of such reserve for deferred taxes for the period used in determining the taxpayer's expense in computing cost of service in such ratemaking. Because the ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT). Thus, the order by Commission is not in accord with the normalization requirements.

Regarding the second issue, § 1.167(l)-1(h)(1)(iii) makes clear that the effects of an NOLC must be taken into account for normalization purposes. Section 1.167(l)-1(h)(1)(iii) provides generally that, if, in respect of any year, the use of other than regulatory depreciation for tax purposes results in an NOLC carryover (or an increase in an NOLC which would not have arisen had the taxpayer claimed only regulatory depreciation for tax purposes), then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director. While that section provides no specific mandate on methods, it does provide that the Service has discretion to determine whether a particular method satisfies the normalization requirements. The "with or without" methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of "flow through" of the benefits of accelerated depreciation to ratepayers. Under these specific facts, any method other than the "with and without" method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

Regarding the third issue, assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would, in effect, flow the tax benefits of accelerated depreciation deductions through to rate payers. This would violate the normalization provisions.

We rule as follows:

1. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
2. For purposes of Ruling 1 above, the use of a balance of Taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with and without" basis would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1 of the Income Tax regulations.
3. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would be inconsistent with the requirements of § 168(i)(9) and § 1.167(l)-1.

This ruling is based on the representations submitted by Taxpayer and is only valid if those representations are accurate. The accuracy of these representations is subject to verification on audit.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the matters described above.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative. We are also sending a copy of this letter ruling to the Director.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

ATTACHMENT C

Advice No. 4777

Internal Revenue Code
Section 168(k)

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to estates of decedents dying and gifts made after December 31, 2010.

(2) CONFORMING AMENDMENT RELATING TO GENERATION-SKIPPING TRANSFERS.—The amendment made by subsection (b)(2) shall apply to generation-skipping transfers after December 31, 2010.

26 USC 121 note.

SEC. 304. APPLICATION OF EGTRRA SUNSET TO THIS TITLE.

Section 901 of the Economic Growth and Tax Relief Reconciliation Act of 2001 shall apply to the amendments made by this title.

TITLE IV—TEMPORARY EXTENSION OF INVESTMENT INCENTIVES

SEC. 401. EXTENSION OF BONUS DEPRECIATION; TEMPORARY 100 PERCENT EXPENSING FOR CERTAIN BUSINESS ASSETS.

26 USC 168.

(a) IN GENERAL.—Paragraph (2) of section 168(k) is amended—

(1) by striking "January 1, 2012" in subparagraph (A)(iv) and inserting "January 1, 2014", and

(2) by striking "January 1, 2011" each place it appears and inserting "January 1, 2013".

(b) TEMPORARY 100 PERCENT EXPENSING.—Subsection (k) of section 168 is amended by adding at the end the following new paragraph:

Applicability.

"(5) SPECIAL RULE FOR PROPERTY ACQUIRED DURING CERTAIN PRE-2012 PERIODS.—In the case of qualified property acquired by the taxpayer (under rules similar to the rules of clauses (ii) and (iii) of paragraph (2)(A)) after September 8, 2010, and before January 1, 2012, and which is placed in service by the taxpayer before January 1, 2012 (January 1, 2013, in the case of property described in subparagraph (2)(B) or (2)(C)), paragraph (1)(A) shall be applied by substituting '100 percent' for '50 percent'.".

(c) EXTENSION OF ELECTION TO ACCELERATE THE AMT CREDIT IN LIEU OF BONUS DEPRECIATION.—

Time periods.

(1) EXTENSION.—Clause (iii) of section 168(k)(4)(D) is amended by striking "or production" and all that follows and inserting "or production—

"(I) after March 31, 2008, and before January 1, 2010, and

"(II) after December 31, 2010, and before January 1, 2013,

shall be taken into account under subparagraph (B)(ii) thereof,".

(2) RULES FOR ROUND 2 EXTENSION PROPERTY.—Paragraph (4) of section 168(k) is amended by adding at the end the following new subparagraph:

"(I) SPECIAL RULES FOR ROUND 2 EXTENSION PROPERTY.—

Applicability.

"(i) IN GENERAL.—In the case of round 2 extension property, this paragraph shall be applied without regard to—

"(I) the limitation described in subparagraph (B)(i) thereof, and

"(II) the business credit increase amount under subparagraph (E)(iii) thereof.

"(ii) TAXPAYERS PREVIOUSLY ELECTING ACCELERATION.—In the case of a taxpayer who made the election under subparagraph (A) for its first taxable year ending after March 31, 2008, or a taxpayer who made the election under subparagraph (H)(ii) for its first taxable year ending after December 31, 2008—

"(I) the taxpayer may elect not to have this paragraph apply to round 2 extension property, but

"(II) if the taxpayer does not make the election under subclause (I), in applying this paragraph to the taxpayer the bonus depreciation amount, maximum amount, and maximum increase amount shall be computed and applied to eligible qualified property which is round 2 extension property.

The amounts described in subclause (II) shall be computed separately from any amounts computed with respect to eligible qualified property which is not round 2 extension property.

"(iii) TAXPAYERS NOT PREVIOUSLY ELECTING ACCELERATION.—In the case of a taxpayer who neither made the election under subparagraph (A) for its first taxable year ending after March 31, 2008, nor made the election under subparagraph (H)(ii) for its first taxable year ending after December 31, 2008—

"(I) the taxpayer may elect to have this paragraph apply to its first taxable year ending after December 31, 2010, and each subsequent taxable year, and

"(II) if the taxpayer makes the election under subclause (I), this paragraph shall only apply to eligible qualified property which is round 2 extension property.

"(iv) ROUND 2 EXTENSION PROPERTY.—For purposes of this subparagraph, the term 'round 2 extension property' means property which is eligible qualified property solely by reason of the extension of the application of the special allowance under paragraph (1) pursuant to the amendments made by section 401(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (and the application of such extension to this paragraph pursuant to the amendment made by section 401(c)(1) of such Act).".

(d) CONFORMING AMENDMENTS.—

(1) The heading for subsection (k) of section 168 is amended by striking "JANUARY 1, 2011" and inserting "JANUARY 1, 2013".

26 USC 168.

(2) The heading for clause (ii) of section 168(k)(2)(B) is amended by striking "PRE-JANUARY 1, 2011" and inserting "PRE-JANUARY 1, 2013".

(3) Subparagraph (D) of section 168(k)(4) is amended—

(A) by striking clauses (iv) and (v),

(B) by inserting "and" at the end of clause (ii), and

(C) by striking the comma at the end of clause (iii) and inserting a period.

(4) Paragraph (5) of section 168(l) is amended—

(A) by inserting "and" at the end of subparagraph (A),

(B) by striking subparagraph (B), and

(C) by redesignating subparagraph (C) as subparagraph (B).

26 USC 168.

(5) Subparagraph (C) of section 168(n)(2) is amended by striking "January 1, 2011" and inserting "January 1, 2013".

(6) Subparagraph (D) of section 1400L(b)(2) is amended by striking "January 1, 2011" and inserting "January 1, 2013".

(7) Subparagraph (B) of section 1400N(d)(3) is amended by striking "January 1, 2011" and inserting "January 1, 2013".

Applicability.
26 USC 168 note.

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to property placed in service after December 31, 2010, in taxable years ending after such date.

(2) TEMPORARY 100 PERCENT EXPENSING.—The amendment made by subsection (b) shall apply to property placed in service after September 8, 2010, in taxable years ending after such date.

SEC. 402. TEMPORARY EXTENSION OF INCREASED SMALL BUSINESS EXPENSING.

(a) DOLLAR LIMITATION.—Section 179(b)(1) is amended by striking "and" at the end of subparagraph (B) and by striking subparagraph (C) and inserting the following new subparagraphs:

"(C) $125,000 in the case of taxable years beginning in 2012, and

"(D) $25,000 in the case of taxable years beginning after 2012.".

(b) REDUCTION IN LIMITATION.—Section 179(b)(2) is amended by striking "and" at the end of subparagraph (B) and by striking subparagraph (C) and inserting the following new subparagraphs:

"(C) $500,000 in the case of taxable years beginning in 2012, and

"(D) $200,000 in the case of taxable years beginning after 2012.".

(c) INFLATION ADJUSTMENT.—Subsection (b) of section 179 is amended by adding at the end the following new paragraph:

"(6) INFLATION ADJUSTMENT.—

"(A) IN GENERAL.—In the case of any taxable year beginning in calendar year 2012, the $125,000 and $500,000 amounts in paragraphs (1)(C) and (2)(C) shall each be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting 'calendar year 2006' for 'calendar year 1992' in subparagraph (B) thereof.

"(B) ROUNDING.—

"(i) DOLLAR LIMITATION.—If the amount in paragraph (1) as increased under subparagraph (A) is not a multiple of $1,000, such amount shall be rounded to the nearest multiple of $1,000.

"(ii) PHASEOUT AMOUNT.—If the amount in paragraph (2) as increased under subparagraph (A) is not

ATTACHMENT D

Advice No. 4777

Ruling Request for Southern California Gas Company

October 01, 2014

VIA EXPRESS DELIVERY

Associate Chief Counsel
Passthroughs & Special Industries
Internal Revenue Service
Attn: CC:PA:LPD:DRU, Room 5336
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Ruling Request for Southern California Gas Company (EIN# 95-1240705)

Dear Sir or Madam:

A ruling is respectfully requested on behalf of Southern California Gas Company ("SCG" or "Taxpayer") regarding the application of the depreciation normalization rules of §168(i)(9) of the Internal Revenue Code of 1986, as amended ("Code"), and Treas. Reg. §1.167(1)-1 ("Normalization Rules") to certain accounting and regulatory procedures which are described in detail hereafter.

A check in the amount of $19,000 is enclosed which represents the user fee associated with this request.

STATEMENT OF FACTS

Taxpayer

SCG is incorporated under the laws of the State of California. SCG's principle place of business is located at 555 West 5th Street, Los Angeles, California 90013. Its telephone number is (213) 244-1200 and its taxpayer identification number is 95-1240705. Taxpayer employs the

accrual method of accounting and reports on a calendar year basis. SCG is wholly-owned by Sempra Energy ("Sempra"), also a California corporation. Sempra maintains its principal place of business at 101 Ash Street, San Diego, California 92101, its telephone number is (619) 696-2000 and its taxpayer identification number is 33-0732627.

SCG is included in a consolidated Federal income tax return of which Sempra is the common parent. This return is filed with the Internal Revenue Service Center in Ogden, Utah and is under the audit jurisdiction of the Large Business and International Division (Natural Resources and Construction) of the Internal Revenue Service ("IRS" or "Service").

Taxpayer's Business

SCG is an investor-owned public utility primarily engaged in the business of supplying natural gas service to customers in an approximately 20,000 square-mile area of Central and Southern California. Taxpayer serves the approximately 20.9 million people in its service territory through approximately 5.8 million customer accounts. SCG is subject to regulation by the California Public Utilities Commission ("CPUC") with respect to the terms and conditions of service and particularly as to the rates it can charge for the provision of service. Its rates are established on a cost-of-service basis.

Taxpayer's 2012 Rate Case

By CPUC order, SCG files a general rate case ("GRC") application with the CPUC every three to four years. The CPUC uses forecasted test year ratemaking. SCG filed an application for a test year 2012 GRC on December 15, 2010 (Docket A.10-12-006). SCG used as its starting point recorded 2009 data and then projected 2010 through 2012 data. SCG updated, amended, and supplemented its data several times during the course of the proceedings. Rates in this

proceeding were intended to, and did, go into effect (retroactively) for the period January 1, 2012 through December 13, 2015 based on CPUC Decision D.13-05-010 issued on May 9, 2013.

In computing its cost-of-service for Federal income tax expense, SCG normalized the tax benefits attributable to accelerated depreciation. SCG also anticipated that it would claim accelerated depreciation (including "bonus" depreciation) on its tax returns to the extent that such depreciation was available under then-current law in all years for which data was provided. Primarily as a result of forecasted bonus depreciation, SCG forecasted taxable net operating losses ("NOLs") of approximately $35.4 million in 2010, $164.5 million in 2011, and-$21.5 million in 2012. Taxable income was computed on a “with and without” bonus depreciation method. NOLs were generated when taxable income was computed with bonus depreciation, but NOLs did not occur when taxable income was computed without bonus depreciation. The collective projected NOLs included approximately $1 billion of accelerated depreciation deductions (i.e., tax depreciation in excess of book depreciation). SCG anticipated that it would have the ability to carry back approximately $213.9 million of this NOL, with the remainder producing a net operating loss carry forward ("NOLC") of $57.6 million as of the end of 2011 and $7.5 million as of the end of 2012, representing the beginning and ending of the test year.[1]

Over the course of the 2010-2012 forecasted period, the CPUC approved income tax expense of $261.8 million in the cost of service. Over the same forecasted period, the CPUC approved increasing the reserve for accumulated deferred income taxes by $320.5 million, representing the entire tax-effected difference between accelerated tax and regulatory

[1] All amounts and computations in the rate case filing were on a separate company basis. On a consolidated basis, Sempra energy also had NOLs and NOLCs over this period.

depreciation without adjustment for the NOLC at the beginning and end of any forecast year or the test year.

Taxpayer's Accounting for Its Projected NOLCs

In the usual situation in which an excess of temporary tax deductions over book expenses reduces a taxpayer's positive taxable income, such excess deductions reduce (i.e., defer) the tax liability it would otherwise pay and, thereby, produces incremental cash flow for use by the taxpayer. The existence of this incremental cash is recorded in a set of entries that creates a reserve for deferred taxes. The following example illustrates the Federal income tax accounting entries, given the following assumptions:

ASSUMPTIONS		
Pre-tax book income	$1,000	
Temporary tax deductions in excess of book expenses	$1,000	
Taxable income	$0	
Tax rate	35%	
ACCOUNTING ENTRIES		
	DR.	CR.
Current tax expense (a/c 409- income statement)[2]	$0	
Taxes payable (a/c 236-balance sheet)		$0
Deferred tax expense (a/c 410- income statement)	$350	

[2] The designation "a/c" refers to the account number used by Taxpayer in its accounting records, including its regulated books of account. These account numbers are prescribed by the Federal Energy Regulatory Commission (“FERC”).

Accumulated deferred taxes (a/c 282- balance sheet)	$350

In the example above, total tax expense is $350, all of which is deferred tax expense recoverable in rates. The accumulated deferred income taxes ("ADIT") account reflects a credit balance of $350.

However, when a taxpayer incurs a tax net operating loss that results in an NOLC, a portion of the deductions claimed in that period does not, in fact, defer tax payments. That portion merely creates or increases the NOLC. Thus, while this portion has the capacity to reduce Taxpayer's tax payments in the future, it does not provide any current cash tax benefit. When an NOLC occurs, Taxpayer makes a set of accounting entries to reflect these economic realities, including recording a deferred tax asset for the expected future utilization of the NOLC to offset tax payments. An example follows which illustrates the Federal income tax accounting entries when an NOLC occurs, given the following assumptions:

ASSUMPTIONS		
Pre-tax book income	$1,000	
Tax deductions in excess of book expenses	$2,500	
Taxable loss/NOLC	($1,500)	
Tax rate	35%	
ACCOUNTING ENTRIES		
The basic entries:	DR.	CR.
Current tax expense (a/c 409 – income statement	$0	

Taxes payable (a/c 236 – balance sheet)		$0
Deferred tax expense (a/c 410 – income statement)	$875	
Accumulated deferred taxes (a/c 282 – balance sheet)		$875
And to reflect the impact of the NOLC:		
Deferred tax assets (a/c 190 – balance sheet)	$525	
Deferred tax expense (a/c 410 – income statement)		$525

When the two series of entries described above are combined, the net entries are as follows:

COMBINED ACCOUNTING ENTRIES		
	DR.	CR.
Current tax expense (a/c 409- income statement)	$0	
Taxes payable (a/c 236- balance sheet)		$0
Deferred tax expense (a/c 410 – income statement)	$350	
Deferred tax assets (a/c 190- balance sheet)	$525	
Accumulated deferred taxes (a/c 282- balance sheet)		$875

In this example, total tax expense is again $350, all of which is deferred tax expense recoverable in rates. The amount of tax expense recoverable in rates in this example ($350), however, is less than the amount of deferred tax deductions in excess of book expenses ($875). The deferred income tax expense attributable to the tax deductions in excess of book expenses ($875) is reduced by the negative deferred income tax expense related to the NOLC ($525). The combined ADIT accounts reflect a net $350 balance, which consists of two components - $875 in

a/c 282 (deferred tax liability or "DTL") and a partially offsetting $525 entry in a/c 190 (deferred tax asset or "DTA").

In its rate case, SCG applied the above accounting to its projected 2011 and 2012 NOLCs. Taxpayer projected that, as of the end of 2012, it would reflect approximately $750.9 million of Federal ADIT in a/c 282 and that it would reflect a DTA attributable to its Federal NOLC of approximately $7.5 million.[3]

Ratemaking for Taxpayer's NOLCs

In the setting of utility rates in California, a utility's rate base is offset by its average ADIT balance. In its rate case filing and throughout the proceeding, SCG maintained that the amount by which rate base should be reduced as of the end of 2012 was $750.9 million of ADIT (a/c 282), net of approximately $7.5 million balance in a/c 190 (the DTA attributable to the Federal NOLC). This net amount represented the true measure of forecasted Federal income taxes deferred by claiming accelerated tax depreciation deductions at the end of 2012. This is also the actual amount of "cost-free" capital SCG would have available due to accelerated tax depreciation deductions over book depreciation reflected in the rate case. SCG also asserted that not reducing the DTL in rate base by the DTA generated by the NOLC balance recorded in a/c 190 would be inconsistent with the Normalization Rules (discussed in detail below).

During the proceeding, the Division of Ratepayer Advocates ("DRA"), a division of the CPUC representing ratepayer interests, issued a report that was included in the record of the case

[3] For ratemaking purposes, taxpayer uses a 13 month weighted-average calculation for all components of ratebase: plant, reserve for depreciation, and accumulated deferred federal income taxes.

in which it took issue with SCG's treatment of its NOLC. DRA's testimony stated, in pertinent part:

> DRA recommends the deferred tax be recognized and flowed through as a rate base adjustment in the year in which the book depreciation is recognized and the tax deduction associated with bonus depreciation is available. Further, DRA recommends that any deductions lost by adhering to SCG's methodology resulting in a NOL be applied in the year available.

In effect, DRA argued for inclusion of the entire DTL balance at the beginning and end of the test year without offset for the DTA balances produced by the NOLCs as a reduction to rate base. SCG countered that "an NOL does not reduce current taxes paid by the utility and does not provide a current source of cash, but does create an asset indicative of a future cash tax benefit not yet received."[4]

After considering arguments made by SCG, DRA, and other intervening parties to the regulatory proceeding, the CPUC issued Decision D.13-05-010 on May 9, 2013 (two excerpts of which are appended as Attachment 1 and Attachment 2).[5] In the summary section of the Decision, the CPUC held:

> SoCalGas proposes to record in rate base a deferred tax asset due to a NOL carry-forward. In D.12-11-051 in SCE's[6] GRC, the Commission declined to allow SCE to record to rate base as an asset the unused deferred tax liability that occurs due to a NOL. In that decision, the Commission concluded as follows:

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[4] Excerpted from "Prepared Rebuttal Testimony of Randall G. Rose on Behalf of San Diego Gas and Electric Company and Southern California Gas Company" dated October 2011.

[5] The complete Decision runs to over 1,180 pages. Attachment 1, Section 20.4.3 is the portion of the Decision that discusses Taxpayer's NOLC. Attachment 2, item numbers 424 and 425 include the related "Findings of Fact". The entire Decision may be accessed online at http://docs.cpuc.ca.gov/DecisionsSearchForm.aspx.

[6] "SCE" refers to Southern California Edison, an electric public utility company under CPUC jurisdiction. SCE and SCG are unrelated parties.

> We find it is not appropriate to include the NOL in rate base for ratemaking purposes. First, it is a placeholder amount and, second, it would be unfair to ratepayers to essentially pay a carrying charge on SCE's expected future recovery of a tax benefit when the ratepayers have already paid the tax expense in rates.
>
> It is the intent of the Commission that SCE comply with the normalization method of accounting and tax normalization regulations. However, SCE did not provide any statute or regulation which requires the Commission to permit a rate of return on a temporary ADIT asset. SCE may track the NOL, and if SCE later obtains a ruling from the IRS which affirms SCE's position, SCE may file a Tier 2 AL with the Energy Division seeking an adjustment to revenue requirement. (D.12-11-051 at 619.)

We conclude that it is appropriate to treat the Applicants' NOL in similar fashion. Thus it is reasonable to allow SDG&E and SoCalGas to apply bonus depreciation to current tax expenses, and allow SoCal Gas to delay recording unused deferred tax liabilities against ratebase until they are used. However, it is unreasonable for SoCalGas ratepayers to provide a rate of return on a deferred tax asset based on a NOL. As a result, the Results of Operations in Attachment B excludes any NOL-based deferred asset from ratebase. To the extent applicable, SDG&E[7] and SoCalGas may file a Tier 1 advice letters to create memorandum accounts to track any NOL that may arise due to bonus depreciation, and either utility may file a Tier 2 advice letter seeking an adjustment to its revenue requirement if an IRS ruling supporting such an adjustment is obtained.[8]

In the Findings of Fact #25, the CPUC found "it is unreasonable for SoCalGas ratepayers to provide a rate of return on a deferred NOL."[9] The result of the decision was the exclusion of

[7] "SDG&E" refers to San Diego Gas & Electric Company, an electric public utility company under CPUC jurisdiction. SDG&E, like SCG, is a wholly-owned subsidiary of Sempra. SDG&E did not have an NOLC.

[8] CPUC D.13-05-010, p.952-953.

[9] Ibid, p. 1085.

the NOLC-related DTA from the reserve for deferred taxes in SCG's ratebase and no delay in recording unused deferred tax liabilities against ratebase until they are used.

RULINGS REQUESTED

This ruling request is being submitted to support Taxpayer's rate case position with regard to its treatment of its NOLC such that the CPUC will entertain the remedial action it described in D.13-05-10. SCG asserts that ratepayers have not "already paid the tax expense in rates," at least not to the extent of the entire deferred tax expense. SCG contends that the tax expense paid by ratepayers in the cost of service is no more than the net amount of the combined DTL and DTA.

Taxpayer respectfully requests the following rulings:

1.A. Under the circumstances described above, the reduction of Taxpayer's rate base by the full amount of its AD1T account (a/c 282) balance unreduced by the balance of its NOLC-related account (a/c 190) balance would be inconsistent with (and, hence, violate) the requirements of Code §168(i)(9) and Treasury Regulations §1.167(l)-a.

1.B. For purposes of Ruling 1.A. above, the use of a balance of Taxpayer's NOLC-related account (a/c 190) balance that is less than the amount attributable to accelerated depreciation computed on a "with and without" basis would be inconsistent with (and, hence, violate) the requirements of Code §168(i)(9) and Treasury Regulations §1.167(l)-a.

2. Under the circumstances described above, the assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account (a/c 190) balance would be inconsistent with (and, hence, violate) the requirements of Code §168(i)(9) and Treasury Regulations §1.167(1)-1.

STATEMENT OF LAW

Taxpayer's ruling request is based on precedent. Former Code §38(c)(l) provided that an investment tax credit ("ITC") is allowed only to the extent its use is not limited by the taxpayer's tax liability.

Code §168(f)(2) provides that MACRS depreciation does not apply to any public utility property if the taxpayer does not use a normalization method of accounting.

Code §168(i)(9) provides that, in order to use a normalization method of accounting, if a taxpayer claims a depreciation deduction that differs from its regulatory depreciation, the taxpayer must make an adjustment to a reserve to reflect the deferral of taxes resulting from such difference. It further provides that any procedure or adjustment that is used for tax expense, depreciation expense or the reserve for deferred taxes must be used with respect to tax expense and depreciation expense and with respect to rate base.

Treas. Reg. §1.46-6(b)(4) provides that cost of service or rate base will be considered to have been reduced if such reduction is made in an indirect manner.

Treas. Reg. §1.46-6(g)(2) provides that the ITC normalization rules permit the ratable amortization only of ITC "allowed."

Treas. Reg. §1.167(1)-l(h)(l)(iii) provides that, if, in respect of any year, the use of other than regulatory depreciation for tax purposes results in an NOLC (or an increase in an NOLC which would not have arisen had the taxpayer claimed only regulatory depreciation for tax purposes), then the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director.

Treas. Reg. §1.167(1)-l(h)(6)(i) provides that a taxpayer does not use a normalization method of accounting if the reserve by which rate base is reduced exceeds the amount of such

reserve used in determining the taxpayer's expense in computing cost of service in such ratemaking.

PLRs 7836038 (June 8, 1978) and 7836048 (June 9, 1978) both addressed the use by California regulators of the "average annual adjustment method" ("AAAM") for setting rates. In each of the rulings, the Service held that the AAAM violated the Normalization Rules because it flowed through a portion of the reserve for deferred taxes to customers.

PLR 8818040 (February 9, 1988) involved a taxpayer who generated NOLCs in 1985 and 1986 which it carried forward and used to offset taxable income in 1987. Accelerated depreciation claimed with respect to public utility property contributed to the NOLCs. The tax rate was 46% in both 1985 and 1986 and was 39.95% in 1987. The taxpayer recorded no deferred taxes applicable to the depreciation that produced the NOLCs in the years in which the deductions were claimed (1985 and 1986) but, instead, recorded the applicable deferred taxes in 1987 when the NOLCs were absorbed at the lower 39.95% tax rate in effect in that year. The Service held that this procedure complied with the Normalization Rules.

PLR 8903080 (October 26, 1988) addressed, *inter alia*, a situation in which the taxpayer generated an NOL which could be carried back to a year in which the tax rate was higher than the tax rate applicable to the year in which the NOL was generated. The Service ruled that the allocation of the benefit of the higher tax rate ratably to all book-tax timing differences, including accelerated depreciation, incurred in the NOL year complied with the Normalization Rules.

PLR 9309013 (December 1, 1992) involved a utility taxpayer who had made an election to treat its investment tax credits ("ITC") pursuant to the requirements of former Code §46(f)(2).

The taxpayer claimed ITC with respect to certain public utility property which it was unable to use due to the limitation based on its tax liability of Code §38(c)(l). The unused ITC was carried forward. The Service ruled that the ITC normalization rules (of former Code §46(f)) would be violated if the ITC was used to reduce cost of service in a period before it was used as an offset against Federal income tax.

In PLR 9336010 (June 7, 1993) the Service again addressed a situation in which the taxpayer generated an NOL which could be carried back to a year in which the tax rate was higher than the tax rate applicable to the year in which the NOL was generated. The question raised was the extent to which the NOL carryback was attributable to accelerated depreciation and, hence, gave rise to excess deferred taxes. The Service held that, if no particular items caused the NOL, then an appropriate methodology would be the pro rata allocation of the excess deferred taxes to all timing differences for the year of the NOL.

PLR 201418024 (May 2, 2014) addressed a situation where the taxpayer's regulators did not allow a deferred tax asset generated by forecasted NOLCs to reduce the ADIT reserve in the construct of rate base. Under the facts of the ruling, taxpayer had, in the aggregate, produced more net operating losses than taxable income. After application of the carryback and carryforward rules, the taxpayer represented that it had an NOLC as of the end of the test year. The amount of accelerated depreciation exceeded the amount of the NOLCs for those years. Subsequently, the taxpayer produced regular taxable income but could not offset the entire alternative minimum tax ("AMT") liability due to the limitation in Code §56(d). The taxpayer asserted that it normalizes the difference between regulatory depreciation and tax depreciation. The taxpayer maintains an ADIT account and also maintains an offsetting series of entries to

reflect that portion of those deferred taxes that did not actually reduce taxes due the NOLC. In its GRC, the Commission asserted that in setting rates, it includes a provision for deferred taxes based on the entire difference between accelerated depreciation and regulatory depreciation, including in situations such as this, where the utility has an NOLC. Both the utility and the Commission represented that the tax expense recovered in the cost of service was sufficient to collect amounts from ratepayers equal to income taxes that would have been due absent the NOLC and the minimum tax credit carryforward ("MTCC"). Both the taxpayer and the Commission at all times intended to follow the Normalization Rules. The taxpayer requested a ruling that under the circumstances described above, the reduction of ratebase by the full amount of the ADIT account without regard to the balances in its NOLC-related account and its MTCC-related account was consistent with the requirements of Code §168(i)(9) and Treas. Reg. §1.167(l)-1. The IRS gave a very limited ruling in support of the taxpayer's request, based on the facts as represented. Specifically, the ruling was predicated on the Commission's assertions that, in setting rates, it included a provision for deferred taxes based on the entire difference between accelerated tax and regulatory deprecation, including situations in which a utility has an NOLC or AMT. The ruling expressed no opinion on whether that assertion was supported, but only that the IRS relied on the assertion in making its ruling.

In PLR 104157-14 (June 12, 2014), the Service addressed the same NOLC and normalization issues that are the subject of this ruling request.[10] The taxpayer in PLR 104157-14 was an investor-owned public utility headquartered in Southern California and subject to

[10] The taxpayer in PLR 104157-14 is the same Southern California Electric utility whose regulatory decision was cited by the CPUC as the basis for its decision not to allow SCG's inclusion of its DTA resulting from the NOLC as an offset to the DTL in SoCal Gas' rate base (see footnote #6).

regulation by Commissions A and B. The taxpayer in the ruling claimed accelerated depreciation, including bonus depreciation, on its tax returns and incurred NOLs that produced an NOLC into subsequent tax years. In the taxpayer's rate case filing and proceedings, it maintained that the ADIT balance should be reduced by the amounts that did not actually defer tax due to the presence of the NOLC. The taxpayer's position was that the rate base should be reduced by its Federal ADIT balance net of the deferred tax account attributable to the Federal NOLC, and to reduce the rate base by the full amount of the ADIT would be inconsistent with the Normalization Rules. Commission A held that it was inappropriate for the taxpayer to include the NOLC in rate base, but it further held that the taxpayer would be entitled to file with the Commission for an adjustment if the taxpayer later obtained a ruling from the Service affirming the taxpayer's position. The Service ruled in favor of the taxpayer on all three of the taxpayer's requested rulings. Specifically, the Service ruled that:

(1) the reduction of the taxpayer's rate base by the full amount of its ADIT account balance unreduced by the balance of its NOLC-related account balance would be inconsistent with the requirements of the Normalization Rules;

(2) the use of a balance of the taxpayer's NOLC-related account balance that is less than the amount attributable to accelerated depreciation computed on a "with and without" basis would be inconsistent with the Normalization Rules; and

(3) the assignment of a zero rate of return to the balance of the taxpayer's NOLC-related account balance would be inconsistent with the Normalization Rules.

DISCUSSION AND ANALYSIS

Requested Ruling #1.A.

As a result of the NOLC Taxpayer projected for 2012, its ability to benefit from some of its accelerated depreciation tax deductions in those years will have been delayed until such time as the NOLC can be used to offset future taxable income and thereby reduce a future tax liability. Treas. Reg. §1.167(1)-l(h)(l)(iii) is the only place in the normalization regulations in which an NOLC is mentioned. That subparagraph applies when a taxpayer produces an NOLC and claims depreciation deductions that exceed regulatory (*i.e.*, book) depreciation for the year.[11] In such a situation, the section provides that the tax deferral shall be taken into account for regulatory purposes in such time and manner as is satisfactory to the district director. This provision suggests that the requirements under the Normalization Rules for the timing of tax benefit recognition may not be the same when there is an NOLC and when there is not. In other words, it identifies an NOLC situation as one that is distinctive under the Normalization Rules. Its very existence indicates that the regulatory treatment of an NOLC has normalization implications. The involvement of the district director would, of course, be unnecessary unless the timing and manner of benefit recognition was important to compliance with the Normalization Rules. So, while this provision may not prescribe a definitive answer or remedy, it suggests that a resolution in compliance with the Normalization Rules is necessary.

Treas. Reg. §1.167(1)-l(h)(6)(i) is potentially much more directly relevant to Taxpayer's situation. This provision imposes a limitation on the extent to which a taxpayer can reduce its rate base by its ADIT reserve. The provision appears to require that any ADIT balance used to

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[11] This regulation section employs a "with and without accelerated depreciation" measurement in order to determine whether the district director's discretion is necessary to resolve the issue.

reduce rate base must have been reflected as deferred tax expense in computing cost of service. In other words, there is a necessary connection between deferred taxes in cost of service and the permissible ADIT balance by which rate base can be reduced. From an accounting, as well as an economic reality perspective, such a connection clearly must, and does, exist. The provision suggests that, in order to comply with the Normalization Rules, this connection must also exist in establishing rates. The regulation itself offers no rationale for this rule, however, it is obvious that it was intended to preclude the extraction of the benefits of accelerated depreciation by inflating the ADIT balance beyond what is economically justified. In fact, this was the basis upon which the Service found the AAAM used by the regulators in California inconsistent with the Normalization Rules. The "consistency rules" of Code §168(i)(9)(B) make (and were enacted to make) absolutely clear that identical ratemaking conventions must be applied to the computation of depreciation expense, tax expense, the ADIT reserve and rate base. In recognizing ADIT for purposes of computing rate base that has not been reflected in tax expense, two differing conventions are being applied that may contravene these provisions.

A review of the accounting entries on pages 5-6 of this request demonstrates the inconsistency. The combined entries in the example where there is an NOLC are as follows:

	DR.	CR.
Current tax expense (a/c 409 – income statement)	$0	
Taxes payable (a/c 236 – balance sheet)		$0
Deferred tax expense (a/c 410 – income statement)	$350	
Deferred tax assets (a/c 190 - balance sheet)	$525	
Accumulated deferred taxes (a/c 282 – balance sheet)		$875

These entries demonstrate that, in the example cited, the deferred tax expense included in cost of service is $350. If the DTA (a/c 190) is ignored for purposes of determining the quantity of ADIT by which to offset rate base, the ratebase offset amount would be $875. Consequently, the rate base offset would exceed the deferred tax expense included in cost of service, a situation that, on its face, conflicts with the Normalization Rule notion of consistency. The ruling in PLR 201418024 captured this principle by acknowledging the assertions by the taxpayer and the Commission that the reserve for deferred taxes captured the entire difference between accelerated and regulatory depreciation. Mathematically, that would only be possible in the example above if the taxpayer recovered the entire deferred tax expense of $875 in the cost of service rather than the $350 deferred tax expense posted to a/c 410 above.

In terms of the limitation imposed by Treas. Reg. §1.167(1)-l(h)(l)(iii), the ADIT reserve subject to the limitation should not be limited to Taxpayer's a/c 282 balance only. The two accounts (a/c 282 and a/c 190) collectively constitute the reserve for deferred taxes. Treas. Reg. §1.167(1)-1(h)(2) provides that no specific bookkeeping is necessary to record an ADIT reserve so long as the amount of the reserve is identifiable. Thus, the Service is not limited to a single account in determining the application of the limitation. Both accounts must be included in the computation of the limitation. Alternatively, the balance in a/c 282 by itself reflects an amount that exceeds the tax deferred by virtue of claiming accelerated depreciation. In computing the limitation on the amount by which rate base can be reduced, that balance must be adjusted to conform to the requirements of the Normalization Rules – that is, it must be reduced by an amount equal to the balance in a/c 190.

The ITC normalization rules of former Code §46(f) address a situation possibly analogous to Taxpayer's. Under those rules, a taxpayer is not permitted to commence the amortization of its ITC until the credit is used to reduce its Federal income tax liability. See PLR 9309013 (December 1, 1992). Thus, under the ITC branch of the normalization rules, taxpayers are prohibited from providing the benefit of a protected tax attribute to ratepayers before they themselves receive the benefit. To do otherwise would be a violation of the ITC normalization rules. Because the "fronting" of a tax benefit in such a way diminishes the value of the benefit to the utility, the protection of the value of ITC to a utility taxpayer described above suggests that there might be a counterpart requirement in the case of accelerated depreciation.

PLR 8818040 (February 9, 1988) is, so far as Taxpayer is aware, the only pronouncement issued by the Service prior to 2014 which specifically addressed the application of the Normalization Rules in the context of an NOLC. In that ruling, the Service described the circumstances of a taxpayer with an NOLC as follows:

> However, the taxpayer did not realize the entire tax benefit from the ACRS depreciation claimed in 1985 and 1986 because the depreciation resulted in a NOL carryover to 1987. Therefore, in order to reflect the tax benefit of the NOL carryover to 1987, the taxpayer reduced its deferred Federal income tax expense and liability for 1985 and 1986 for financial reporting purposes. The net effect of this accounting in 1985 and 1986 was to record no deferred taxes applicable to the amount of ACRS depreciation that produced no current tax savings but rather caused or increased taxpayer's NOL carryover to 1987. The taxpayer only recorded deferred taxes applicable to ACRS when and to the extent that the use of ACRS produced an actual tax deferral.

The Service concluded that, where the taxpayer produced NOLCs in years in which it claimed accelerated depreciation, its decision not to book deferred taxes in the years in which the

deductions were claimed and its booking of deferred taxes in the year in which the NOLCs were eventually used were consistent with the Normalization Rules.[12]

The Service recently and directly addressed the interplay between NOLCs and the Normalization Rules in PLR 104157-14 (June 12, 2014). In a fact pattern virtually identical to SCG's facts, the Service ruled that the Commission's order that denied the taxpayer from netting its NOLCs against its ADIT balance for ratemaking purposes "is not in accord with the normalization requirements." The Service reasoned that "[b]ecause the ADIT account, the reserve account for deferred taxes, reduces rate base, it is clear that the portion of an NOLC that is attributable to accelerated depreciation must be taken into account in calculating the amount of the reserve for deferred taxes (ADIT)."

The provision to ratepayers of a benefit produced by accelerated depreciation prior to the time that the deduction reduces a tax liability economically diminishes the value of accelerated depreciation. In fact, and counterintuitively, and relevant to this ruling request, a utility subject to such ratemaking (that is, ratemaking that ignores the ADIT impact of the NOLC) would be better off not claiming accelerated depreciation to the extent it creates or increases an NOLC. If it did not claim these additional depreciation deductions, the tax it paid would not be impacted. However, it would not reflect additional and offsetting amounts in a/c 282 and a/c 190. As a result, its rate base would not be reduced by the incremental balance in a/c 282. In short, its rate base would not be reduced by the tax benefit of future tax deferrals.

[12] Note, however, that the issue in PLR 8818040 was not the limitation on the amount by which rate base can be reduced. It was the computation of the tax expense element of cost of service. Therefore, though the situation was economically similar to Taxpayer's, the Service's holding is not directly on point to this ruling request. Moreover, in that ruling the Service held that the taxpayer's delay in the booking of its deferred taxes was consistent with the Normalization Rules - not that to do otherwise would not be.

Requested Ruling #1.B.

In determining the portion of its NOLC (and, hence, its a/c 190 balance) that is attributable to accelerated depreciation subject to the Normalization Rules, Taxpayer applied the "with and without" measurement methodology described in Treas. Reg. §1.167(1)-l(h)(l)(iii). Under this method, an NOLC is attributable to accelerated depreciation to the extent of the lesser of (1) the accelerated depreciation claimed or (2) the amount of the NOLC. In effect, accelerated depreciation is deemed to be the last deduction taken. Note that, for purposes of attributing excess deferred taxes to the items of deduction comprising an NOL carryback, the Service has twice held that the ratable allocation of such excess to all of the book-tax timing differences occurring in the NOL year is permissible under the Normalization Rules. See PLRs 8903080 and 9336010. Since Taxpayer has an NOLC and not an NOL carryback, it has employed the "with and without" technique described in the regulations rather than the ratable allocation approach allowed in the two private letter rulings.

The Service recently ruled in PLR 104157-14 (June 12, 2014) that the “with or without” approach is the methodology that should be utilized by the taxpayer in the ruling, which was a regulated utility that had an NOLC. Specifically, the Service stated:

> The “with or without” methodology employed by Taxpayer is specifically designed to ensure that the portion of the NOLC attributable to accelerated depreciation is correctly taken into account by maximizing the amount of the NOLC attributable to accelerated depreciation. This methodology provides certainty and prevents the possibility of “flow through” of the benefits of accelerated depreciation to ratepayers. Under these facts, any method other than the “with and without” method would not provide the same level of certainty and therefore the use of any other methodology is inconsistent with the normalization rules.

In all cases, the "with and without" measurement methodology will attribute a larger amount of an NOLC to accelerated depreciation than would a "ratable allocation" approach. Thus, Requested Ruling #l.B. asks the Service to rule, as it did in PLR 104157-14, that the use of any method other than the "with and without" method (including the "ratable allocation" method or the total disregard of SCG's a/c 190 balance) would be inconsistent with the Normalization Rules.

Requested Ruling #2

In the portion of the Decision in which the CPUC addressed Taxpayer's treatment of its 2011 and 2012 NOLCs, it concluded that to the extent the Normalization Rules require recording the NOL to rate base in 2011 or 2012, no rate of return is authorized. No other element of Taxpayer's rate base was assigned "no rate of return" and the CPUC provided no independent substantive rationale whatsoever for this unique rate of return assignment. It was merely presented as an alternative in the event that the Normalization Rules preclude excluding the NOLC-related DTA from rate base. Economically, the inclusion of that DTA in rate base while assigning it "no rate of return" would be the precise equivalent of excluding it from rate base altogether. This would achieve through the alternative treatment an economic result that is inconsistent with the Normalization Rules.

While the general Normalization Rules themselves do not specifically address such blatant attempts to finesse their requirements, the ITC normalization rules do. Treas. Reg. §1.46-6(b)(4) states, in pertinent part:

> (i) Cost of service or rate base is also considered to have been reduced by reason of all or a portion of a credit if such reduction is made in an indirect manner.
>
> . . .

> (iii) A second type of indirect reduction is any ratemaking decision intended to achieve an effect similar to a direct reduction to cost of service or rate base.

That provision of the regulations goes on to describe the evidence relevant to determining whether or not an indirect reduction has transpired. This includes the record of the proceeding, the order issued by the regulator and an analysis of the revenue requirement impact of the treatment ordered in comparison to the revenue requirement impact of a direct reduction. Considering this evidence in Taxpayer's rate case, there can be little, if any, doubt that the alternative represents an indirect reduction in rate base. Principles of the ITC normalization rules have commonly been applied to the Normalization Rules.

Sanctioning the ability to do indirectly and with impunity what the Normalization Rules categorically state cannot be done directly would effectively relegate those rules to a trap for the unwary. They would have no continuing viability. The Service recognized this concern in PLR 104157-14 (June 12, 2014) when the Service concluded that the "assignment of a zero rate of return to the balance of Taxpayer's NOLC-related account balance would, in effect, flow the tax benefits of accelerated depreciation deductions through to rate payers. This would violate the normalization provisions."

CONCLUSION

For the reasons set forth above, we respectfully request that the Service issue the rulings requested.

PROCEDURAL MATTERS

A. Statements required by Rev. Proc. 2014-1:

1. Section 7.01(4) – To the best of Taxpayer's knowledge, the issue that is the subject of this requested letter ruling is not addressed in any return of Taxpayer, a related taxpayer within the meaning of §267, or of a member of an affiliated group of which Taxpayer is also a member within the meaning of §1504 that is currently or was previously under examination, before Appeals, or before a Federal court.

2. Section 7.01(5)(a) – Taxpayer, a related party taxpayer within the meaning of §267, or a member of an affiliated group of which Taxpayer is also a member has not, to the best of Taxpayer's knowledge, received a ruling on the issue that is the subject of this requested letter ruling.

3. Section 7.01(5)(b) – To the best of Taxpayer's knowledge, neither Taxpayer, a related taxpayer, a predecessor, nor any representatives previously submitted a request involving the same or a similar issue to the Service but with respect to which no letter ruling or determination letter was issued.

4. Section 7.01(5)(c) – To the best of Taxpayer's knowledge, neither Taxpayer, a related taxpayer, nor a predecessor, previously submitted a request (including an application for change in method of accounting) involving the same or a similar issue that is currently pending with the Service.

5. Section 7.01(5)(d) – To the best of Taxpayer's knowledge, neither Taxpayer nor a related taxpayer are presently submitting additional requests involving the same or a similar issue.

6. Section 7.01(8) – The law in connection with this request is uncertain and the issue is not adequately addressed by relevant authorities.

7. Section 7.01(9) – Taxpayer has included all supportive as well as all contrary authorities of which it is aware.

8. Section 7.01(10) – Taxpayer is unaware of any pending legislation that may affect the proposed transaction.

9. Section 7.02(5) – Taxpayer hereby requests that a copy of the ruling and any written requests for additional information be sent by facsimile transmission (in addition to being mailed) and hereby waives any disclosure violation resulting from such facsimile transmission. Please fax the ruling and any written requests to Randall G. Rose at (619) 696-2999.

10. Section 7.02(6) – Taxpayer respectfully requests a conference on the issues involved in this ruling request in the event the Service reaches a tentatively adverse conclusion.

11. Taxpayer will permit the CPUC to participate in any Associate office conference concerning this ruling request. Taxpayer has provided the CPUC with a copy of this ruling request prior to its being filed.

B. Administrative

1. The deletion statement and checklist required by Rev. Proc. 2014-1 are enclosed.

2. The required user fee of $19,000 is enclosed.

3. A Form 2848 Power of Attorney granting the Taxpayer's employees therein listed the right to represent Taxpayer is enclosed.

If you have any questions or need additional information regarding this ruling request, pursuant to the enclosed Power of Attorney, please contact Randall G. Rose, Sr. Director, Tax at (619) 696-2231.

Respectfully submitted,

Paul H. Yong,
Vice-President, Tax and Chief Tax Counsel

PENALTIES OF PERJURY STATEMENT

Southern California Gas Company

Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the request contains all the relevant facts relating to the request, and such facts are true, accurate, and complete.

Southern California Gas Company

BY: ______________________________

DATE:______________________________

PENALTIES OF PERJURY STATEMENT

Sempra Energy

Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the request contains all the relevant facts relating to the request, and such facts are true, accurate, and complete.

Sempra Energy

BY: ______________________________

DATE:______________________________

ATTACHMENT 1

 Date of Issuance 5/14/2013

Decision 13-05-010 May 9, 2013

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company (U902M) for Authority, Among Other Things, to Increase Rates and Charges for Electric and Gas Service Effective on January 1, 2012.	Application 10-12-005 (Filed December 15, 2010)
And Related Matter.	Application 10-12-006

DECISION ON GENERAL RATE CASES OF SAN DIEGO GAS & ELECTRIC COMPANY AND SOUTHERN CALIFORNIA GAS COMPANY

For SDG&E, we adopt the future net salvage rates that SDG&E proposed based on the following reasons. For the six electric accounts that are subject to the proposed adjustment of TURN and UCAN, SDG&E's future net salvage rates are more representative of the data that SDG&E uses than the data that TURN and UCAN rely on. In addition, the SDG&E witness is more familiar with the SDG&E assets than the witness who is sponsoring the adjustments for TURN and UCAN.

Based on the evidence presented, the future net salvage rates of the Applicants are adopted.

20. Taxes

20.1. Introduction

This section on taxes covers the tax expense of SDG&E and SoCalGas. The tax expense covers the following three categories of taxes: (1) payroll taxes; (2) ad valorem (property-related taxes); and (3) income taxes. Included within this section are the franchise fees that SDG&E and SoCalGas incur.

For payroll tax expense for test year 2012, SDG&E forecasts a total of $16.661 million, and SoCalGas forecasts a total of $37.243 million.[184] For ad valorem taxes, SDG&E forecasts a total of $62.947 million, and SoCalGas forecasts a total of $44.082 million.[185] For income taxes, SDG&E forecasts a total of $171.392 million, and SoCalGas forecasts a total of $133.576 million. For

[184] These two amounts are the payroll taxes for non-capitalized wages. If capitalized payroll taxes are included, SDG&E's forecast would be $32.323 million, and SoCalGas' forecast would be $45.775 million.

[185] These amounts do not include the capitalized ad valorem tax on CWIP. For SDG&E, this amounts to $1.515 million, and $1.747 million for SoCalGas. (*See* Ex. 596 at 12.)

franchise fees, SDG&E forecasts a total of $58.349 million, and SoCalGas forecasts a total of $29.651 million.[186]

In the sub-sections below, we address each of the four categories of expense, and the issues that parties have raised.

20.2. Payroll Taxes

20.2.1. Introduction

As described in Exhibits 298 and 300, the payroll taxes cover the cost of the following: (1) Federal Insurance Contributions Act (social security taxes); (2) Federal Unemployment Tax Act; and (3) California State Unemployment Insurance. The payroll taxes were estimated by applying the tax rate on the test year 2012 O&M and capital labor up to the maximum wage base. Since the payroll taxes are paid for by the employer and the employee, the costs included in this section pertain only to the payroll tax liability of SDG&E and SoCalGas.

20.2.2. Position of the Parties

20.2.2.1. DRA

DRA takes issue with the forecasts of SDG&E and SoCalGas for payroll taxes. Instead of using the Applicants' composite tax rates, DRA's composite tax rate was derived for the five-year average of 2006-2010. DRA also contends that the Applicants' double counted the effect of the increase in the Old Age, Survivors, and Disability Insurance (OASDI).

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[186] The forecasts of SDG&E and SoCalGas for these expenses will be affected by the O&M expense and capital that are adopted in this decision, and will be recalculated to reflect the adopted amounts.

20.2.2.2. TURN and UCAN

TURN takes issue with SoCalGas' forecast of its payroll taxes, while UCAN takes issue with SDG&E's forecast of its payroll taxes. Instead of SoCalGas' forecast of $45.775 million (includes capitalized payroll taxes), TURN forecasts $36.067 million. Instead of SDG&E's forecast of $32.323 million, UCAN forecasts $17.100 million.

The differences between the forecasts of the Applicants, and the forecasts of TURN and UCAN, are because of the different taxable wage base estimates, the change in payroll tax rates, and the forecast of TURN and UCAN for inflation. TURN and UCAN used a wage base estimate of $110,700, which came from the 2011 edition of the Annual Report of the Social Security Trust fund. The Applicants used a wage base estimate of $114,900 which is based on the 2009 edition of that report. For the Social Security payroll tax percentage, the TURN and UCAN calculation reflects the constant maximum income and inflation.

20.2.2.3. SDG&E and SoCalGas

On DRA's reductions to the forecasts of SDG&E and SoCalGas for payroll taxes, the Applicants contend that they did not use the five-year average (2005-2009) to calculate the total composite tax rate as DRA claims. Instead, the Applicants "calculated a companywide composite tax rate for the 2009 base year by dividing total payroll taxes paid in 2009 by 2009 Medicare taxable wages…." (Ex. 302 at 16.) Since the Applicants did not make unauthorized updates to earlier forecasts based on later data, they contend the 2009 represents the correct base year to forecast the test year. Since DRA's total composite tax rate uses a five-year average that includes 2010 data, the Applicants contend that it is inappropriate to make an isolated update using 2010 data. The Applicants also contend that they did not double count the effect of an increase in the OASDI

taxable wage base. The Applicants further contend that their forecasted composite payroll tax rates of 7.15%for SDG&E, and 7.81% for SoCalGas, are reasonable and should be adopted.

Regarding the forecasts of TURN and UCAN, the Applicants acknowledge that the payroll tax data may differ from what was originally forecast when the Applicants submitted their applications. However, the Applicants contend it would be inappropriate to make isolated updates by using 2011 information because "selective updating ignores the fact that while certain costs may be lower than expected, other costs are higher than expected and there is no provision to reflect those instances." (Ex. 302 at 18.) The Applicants also contend that their forecasted composite payroll tax rates are reasonable and should be adopted.

20.2.3. Discussion

We have reviewed the testimony and the arguments concerning the forecasts of the payroll taxes for SDG&E and SoCalGas. We agree with SDG&E and SoCalGas that, under the circumstances and with the update, their forecasts of the payroll taxes are reasonable and should be used instead of adopting the adjustments that DRA, TURN and UCAN have proposed.

20.3. Ad Valorem Taxes

20.3.1. Introduction

The ad valorem taxes cover the taxes paid to the California State Board of Equalization (SBE) on property owned and used by SDG&E and SoCalGas.

The ad valorem taxes "are a function of the assessed value of property and a tax rate applied to that value." (Ex. 298 at 4; Ex. 300 at 3.) The primary indicator of value for utility property that is being assessed is the historical cost less depreciation (HCLD), and the secondary indicator is the capitalized earnings

ability (CEA). According to the Applicants, HCLD is used as the primary indicator of value because it approximates rate base, and the "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." (Ex. 298 at 4; Ex. 300 at 4.) The CEA is an income approach to assessing value, which "is used when the property being appraised is purchased in anticipation of receiving income..., and the actual future income stream can be reliably forecast, or a hypothetical income stream can be estimated by comparison to other similar properties." (*Ibid.*)

None of the other parties oppose the ad valorem forecasts of SDG&E and SoCalGas. Based on our review of the testimony, it is reasonable to adopt to adopt the ad valorem forecasts of SDG&E and SoCalGas.

20.4. Income Taxes

20.4.1. Introduction

The income taxes covered in this section are for the taxes incurred by SDG&E and SoCalGas for federal income tax, and the California Corporation Franchise Tax. In their forecasts of these taxes, SDG&E and SoCalGas used the federal and state tax rates of 35% and 8.84%, respectively. The methodology and adjustments they made are described in greater detail in Exhibits 298 and 300.

DRA has raised two issues with respect to the Applicants' forecasts of income taxes. The first issue pertains to meals and entertainment while on business travel. The second issue deals with recent tax law changes for bonus depreciation, and the effect on net operating losses (NOLs).[187]

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[187] "NOL" is used to refer to a net operating loss.

20.4.2. Meals and Entertainment

20.4.2.1. Position of the Parties

20.4.2.1.1. DRA

DRA recommends that the Applicants' 100% allowance for business travel meals should be reduced to 50%, and that any business travel that includes entertainment and paying for family members be eliminated from the revenue requirement.

DRA contends that the Commission's "ratemaking reflects an Internal Revenue Code limit of 50 percent on the deduction for expenditures on meals incurred as part of business travel," and cites to D.09-03-025 in which the Commission disallowed meals and business expense in SCE's test year 2009 GRC. (Ex. 480 at 7.) DRA also contends that the spending on entertainment and family be eliminated from the revenue requirement because of the Commission's policy that "entertainment, political, and social expenses of utilities...are an unfair economic burden on ratepayers." (Ex. 480 at 8; *See* D.09-03-025 at 315.)

Since DRA's accounting adjustment for these kinds of expenses should have been done earlier, DRA removed "them at a more aggregated level" by making the adjustment in the income tax section. (*See* Ex. 480 at 8-9.) As a result, DRA estimates reductions of $773,000 for SDG&E, and $889,000 for SoCalGas.

20.4.2.1.2. SDG&E and SoCalGas

The Applicants contend that "DRA's proposed adjustments to recoverable costs pertain to the accounting of Applicants'' meals and entertainment expenses, which is outside the scope of Applicants' tax showing." (Ex. 302 at 2.) The Applicants further state that "Federal and state tax laws provide a deduction for only 50% of business meals and entertainment expenses," and that the

"Applicants' respective tax expense calculations will reflect this deduction in accordance with the outcome of this accounting issue." (Ex. 302 at 2-3.)

In their opening brief, the Applicants state that the "company maintains strict policies over [meals and entertainment' that require documentation of business purpose, which are subject to IRS and internal auditing." (Applicants' Opening Brief at 428.) The Applicants also assert that meals and entertainment "serves a business interest by enhancing business relationships with vendors, suppliers and other key constituents who play a role in [SoCalGas'] business in serving ratepayers." (Applicants' Opening Brief at 429.)

20.4.2.2. Discussion

We have reviewed the testimony and arguments of the parties, and also reviewed the decisions cited by DRA. DRA's recommendation to adjust the income taxes is essentially based on its contention that SDG&E and SoCalGas have not justified their meals and entertainment expenses, which are normally addressed as part of the A&G expenses. Instead of recommending an adjustment to the Applicants' A&G expenses, DRA seeks to make that adjustment in the income tax expenses.

We note that neither DRA nor the Applicants have fully investigated the meals and entertainment issue. DRA's audit of the Applicants apparently did not look into this issue, and DRA's A&G witness did not raise this as an issue. On the other hand, the Applicants did not provide any documentation in its rebuttal testimony on taxes that support its argument that the meals and entertainment serve a business interest. In D.09-03-025, the Commission disallowed SCE's meals and entertainment because SCE did not have any accounting safeguards in place to show that these expenses are justified as a business expense.

Based on all these considerations, it is reasonable to adopt DRA's recommendation to make reductions to the income taxes of SDG&E and SoCalGas because the Applicants have not demonstrated that the meals and entertainment expenses serve a useful business-related purpose. However, instead of adopting DRA's amounts, we will reduce the total income tax expense for SDG&E by $500,000, and for SoCalGas by $500,000. Should DRA decide to address the meals and entertainment issue in future GRC applications, it should raise the meals and entertainment issue in connection with the A&G expenses.

20.4.3. Bonus Depreciation and Net Operating Losses

20.4.3.1. Introduction

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Tax Relief Act) provides for an extension and enhancement of bonus depreciation for 2010, 2011, and 2012. Bonus depreciation is an additional amount of deductible depreciation that can be taken in an accelerated manner. In some circumstances, the use of bonus depreciation may result in current tax deductions that exceed taxable income, thus creating NOLs. In such situations, the taxpayer "is allowed to carry back NOLs against taxable income in the prior two years or forward to offset taxable income for the next twenty years." (Ex. 298 at 19; Ex. 300 at 15.)

Both SDG&E and SoCalGas made reductions to their rate base to reflect the impacts of the bonus depreciation provisions of the Tax Relief Act on the accumulated deferred federal income tax (ADFIT). The ADFIT is a result of "the difference between normalized tax depreciation computed using a book life and book method and the comparable tax depreciation computed using ACRS [accelerated cost recovery system] or MACRS [modified accelerated cost

recovery system]…." (Ex. 298 at 15 and 18; Ex. 300 at 12 and 15.) In addition, SoCalGas (but not SDG&E) proposed to include in its rate base a "deferred tax asset created by an NOL carry-forward from prior years that could not be utilized against taxable income in an earlier year." (Ex. 599 at 218.)

Due to time constraints, instead of incorporating bonus depreciation into DRA's version of its Results of Operation model, DRA "constructed a factor to gross-up its deferred taxes offset to ratebase and thereby reflect the impact of the surge in bonus depreciation created by the Tax Relief Act." (Ex. 480 at 12-13; Ex. 302 at 5.)

A brief review of recent legislation and applicable laws is needed in order to understand how bonus depreciation, the ADFIT, and the NOLs affect the Applicants. Since the effective date of the Applicants' last GRC decision, four pieces of federal legislation were enacted that have tax implications for the Applicants' test year 2012 forecasts. The Tax Relief Act extended and enhanced the bonus tax depreciation provisions that were in effect in 2010 pursuant to earlier legislation. Section 401 of the Tax Relief Act amended Internal Revenue Code section 168(k) "to extend the period in which taxpayers may elect to claim bonus tax depreciation on qualified capital additions for income tax reporting purposes." (Ex. 298 at 16; Ex. 300 at 13.) As a result of that amendment, qualified property that is acquired and placed in service after September 8, 2010 and before January 1, 2012, is eligible for 100% bonus depreciation. Property that is acquired and placed in service after
December 31, 2011 and before January 31, 2013 is eligible for 50% bonus

depreciation.[188] According to the Applicants' July 2011 testimony, the "effect of these bonus depreciation provisions is to reduce current income taxes paid and to increase deferred income tax liabilities that will be paid in the future."[189] (*Ibid.*)

The bonus depreciation that is allowed by the Tax Relief Act is subject to the tax normalization rules in Internal Revenue Code section 168 and the Treasury Regulations under former Internal Revenue Code section 167. The tax normalization rules address how to implement the deferral of the benefit from the bonus depreciation, and what can be done with the deferred tax benefit. The normalization rules require that when a utility claims accelerated tax depreciation, such as bonus depreciation, the utility makes an adjustment to a reserve to reflect the amount of deferral of the federal income tax liability resulting from that depreciation. This results in the ADFIT balance.

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[188] On March 29, 2011, the IRS issued Revenue Procedure 2011-26 which sets forth the rules and interpretation concerning the 100% and 50% bonus depreciation allowances set forth in Internal Revenue Code section 168(k). In order to be eligible for the bonus depreciation, the property must meet the requirements set forth in Revenue Procedure 2011-26.

[189] The Applicants quantified the impact of the bonus depreciation in July 2011. At that time, SDG&E's "forecasted deferred taxes increased by $155 million compared to the original filing of December 2010 (deferred taxes increased from $506.9 million to $661.9 million)," and SoCalGas' "forecasted deferred taxes increased by $92.2 million compared to the original filing of December 2010 (deferred taxes increased from $563.7 million to $655.9 million)."(Ex. 302 at 4; Ex. 303.) Subsequently, in Exhibit 338, the Joint Statement of SDG&E, SoCalGas, TURN and UCAN, SDG&E and SoCalGas revised their NOLs. SDG&E now projects it will be in a tax NOL in 2010 of -$17.5 million and 2011 of -$34 million, and no NOL in 2012. SoCalGas projects it will be in a tax NOL position in 2010 of -$35.4 million, 2011 of -$165.9 million, and 2012 of -$29.1 million. (Ex. 338, Att. C.)

20.4.3.2. Position of the Parties

20.4.3.2.1. DRA

The Applicants recomputed their federal tax depreciation on forecasted capital additions to reflect the impact of the 100% and 50% bonus depreciation provisions. As a result of the bonus depreciation, the Applicants state that "current taxes have decreased and deferred federal income tax liabilities have increased compared to the Application filing," and the "increase in the accumulated deferred tax reserve results in a reduction to rate base and the revenue requirement...." (Ex. 298 at 18; Ex. 300 at 15.) Due to the bonus depreciation, SDG&E will be in a tax NOL position in 2010 and 2011, and SoCalGas will be in a tax NOL position in 2010, 2011, and 2012. The Applicants propose carrying back the NOLs to the previous two years, and then carrying forward the remaining NOLs.

DRA opposes the Applicants' carry back and carry forward of the NOLs. DRA recommends that the Applicants' carry back and carry forward proposal be rejected because it believes that D.84-05-036 prohibits the practice of using carry forwards for ratemaking purposes. DRA points to the statement in D.84-05-036 (15 CPUC2d at 55) that states: "We agree that the practice of excluding carry backs and carry forwards from the test-year calculation of income taxes is well founded and should continue."

DRA recommends that its gross-up benefits factor method be adopted to account for the net tax benefits resulting from the Tax Relief Act. DRA had insufficient time to input its forecasts and adjustments into the Results of Operations model that was updated by the Tax Relief Act. To "capture the effect of the bonus depreciation, DRA constructed a factor to gross-up its deferred taxes offset to ratebase and thereby reflect the surge in bonus depreciation

created by the 2010 Tax Relief Act." (Ex. 480 at 12-13) DRA's gross-up factor is composed of the ratio of DRA's Plant-in-Service over the Applicant's Plant-in-Service as originally filed in December 2010, multiplied by the quantity of the Applicant's deferred tax balance from the update less its deferred tax balance from the December 2010 application. DRA contends that this gross up factor captures the effect of the bonus depreciation on ratemaking. DRA's method would result in an approximate increase of $53.241 million to accumulated deferred taxes for SDG&E, and an approximate increase of $86.046 million to accumulated deferred taxes for SoCalGas.

20.4.3.2.2. PG&E

PG&E is opposed to DRA's recommendation that the Applicants be prevented from carrying forward NOLs. PG&E contends that DRA's proposal to eliminate the deferred tax asset would have the effect of reducing the rate base by more than the Applicants are forecasting. PG&E contends that DRA's reliance on D.84-05-036 is in error, and that DRA "confuses income tax expense with deferred income tax liabilities and/or assets."[190]
(Ex. 579 at 2.) PG&E also contends that DRA's gross-up factor proposal could violate the normalization requirements of the Internal Revenue Code.

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[190] PG&E distinguishes between "tax expense" and "deferred taxes." PG&E contends that: "Tax expense is like any other cost in the Results of Operations (RO) that is being currently collected dollar for dollar. 'Deferred taxes' are taxes that are *included* in tax expense (and thus currently collected from customers), but that are not forecasted to be currently paid to the government because of accelerated tax depreciation. Deferred taxes...are treated as government-supplied, not investor-supplied, capital and the utility is not entitled to earn a return on the government-supplied capital. Mechanically,...this is accomplished by deducting deferred taxes from rate base." (Ex. 579 at 4.)

20.4.3.2.3. SCE

SCE takes the position that DRA's proposal to prohibit the Applicants' use of the carry forward of NOLs, and DRA's gross up factor method, are inappropriate. SCE contends that "Under the DRA's proposal, every dollar of accelerated depreciation claimed by the Company on its tax returns will reduce its rate base – even though, to the extent the deductions simply produced an NOL carry forward, they did not defer any tax…." SCE asserts that DRA's gross up factor method would violate the tax normalization rules, and the resulting penalty will harm both ratepayers and shareholders.

20.4.3.2.4. SDG&E and SoCalGas

The Applicants contend that they have properly reflected the bonus depreciation and NOLs in their tax expense, and in their Results of Operation models. They contend that DRA's use of the gross-up factor should be rejected because it is inaccurate, lacks a regulatory foundation, and it significantly overstates the deferred taxes created by the bonus depreciation.

The Applicants contend that the tax normalization rules prevent the Applicants "from passing the current income tax savings resulting from bonus depreciation to ratepayers by lowering the revenue requirement for income tax expense in the cost of service." (Ex. 298 at 17; Ex. 300 at 13.) Since the bonus depreciation acts as an investment incentive for the taxpayer, the tax normalization rules are intended to prevent the customers of regulated utilities from receiving lower rates as a result of reduced tax expense. However, the tax normalization rules allow the ADFIT balance generated by the bonus depreciation to reduce the rate base. According to the Applicants, this reduction in rate base is consistent with the concept that utilities are allowed to earn a

return on investor-supplied capital, but are not entitled to earn a return on government-supplied capital, i.e., the tax savings due to the bonus depreciation.

The bonus depreciation under the Tax Relief Act can result in tax deductions that exceed taxable income in some years, which produces a NOL. The Applicants contend that this deferred tax asset is not utilized "until the company monetizes the extra bonus depreciation benefit by obtaining a refund of prior years' taxes or offsetting future years' taxes." (Ex. 298 at 19; Ex. 300 at 15.) This monetization occurs through the carry back and carry forward of the NOL. SoCalGas proposes to carry forward these unused tax benefits, i.e., NOLs, to future years.

20.4.3.3. Discussion

We reject DRA's proposals that SoCalGas should be prevented from carrying forward NOLs that SoCalGas calculates resulted from the impact of the bonus depreciation pursuant to the Tax Relief Act, and that DRA's gross up factor method be used.

First we analyze whether D.84-05-036 prohibits a carry forward of a NOL. The Applicants, PG&E, and SCE contend that the exclusion of carry backs and carry forwards in D.84-05-036 was only in the context of income tax expense, which is an expense item in a utility's cost of service. The Applicants and the other utilities contend that D.84-05-036 did not address the recognition of deferred taxes [or the rate base impact of carryovers]. DRA takes a contrary view, and argues that D.84-05-036 prohibits the use of carry backs and carry forwards in all situations.

We agree with the Applicants and the other utilities that since the Applicants are not reflecting the carry forward as part of the income tax expense calculation, that this is proper and does not run afoul of the prohibition in D.84-

05-036 that "Carry backs and carry forwards should be excluded from the test-year income tax calculation." (D.84-05-036, Conclusion of Law 8 [15 CPUC2d at 61], emphasis added.) In sections
I (Introduction) and II (Issues Presented) of D.84-05-036, it is clear that the decision was focusing on the "determination of reasonable allowable ratemaking expenses, and on the "test-year income tax expense." (*Id.* at 43-45.)[191] Based on our review of D.84-05-036, and the references cited by DRA, the Applicants, and the other utilities, we agree with the interpretation of the Applicants and the other utilities that D.84-05-036 does not prohibit the carry back or carry forward of deferred taxes.

Second, the Applicants and the other utilities cite several reasons why DRA's gross-up factor should not be adopted.

One of the Applicants' criticisms of DRA's position, is that DRA did not run the Results of Operations model with the Tax Relief Act update with DRA's other adjustments to determine the effects of the bonus depreciation. Instead, "DRA constructed a factor to gross-up its deferred taxes offset to ratebase and thereby reflect the surge in bonus depreciation created by the 2010 Tax Relief Act." (Ex. 480 at 12-13.) We concur with the Applicants that the tax impacts of the bonus depreciation "must be properly modeled in order to produce accurate, reliable, and reasonable results." (Ex. 302 at 5.) That is because the bonus depreciation, when applied to the qualified capital additions, will have a cumulative effect going forward. DRA's gross-up factor does not account for

[191] In the discussion section of D.84-05-036 pertaining to NOL carry backs and carry forwards, it is clear that the decision was referring to carry backs and carry forwards in the context of "calculating the appropriate test-year income tax expense." (15 CPUC2d at 55.)

whether the 50% or 100% bonus depreciation applies, and which assets qualify for this treatment. As a result, DRA's gross-up factor is likely to yield inaccurate results about the impact of bonus depreciation, as opposed to modeling the bonus depreciation in the Results of Operations model.

Another criticism of DRA's gross-up factor is that it will violate the tax normalization rules by including in the ADFIT balance an amount of deferred taxes attributable to claimed but not yet used depreciation deduction, i.e., the monetization issue. We agree that DRA's gross-up factor will conflict with the timing requirement of the tax normalization rules. As pointed out by SCE's witness, if DRA's gross-up factor is used and is determined to violate the tax normalization rules, this could result in adverse impacts on the Applicants as well as on their customers.

We are persuaded by the testimony of the Applicants and the other utilities on bonus depreciation, the tax normalization rules, and NOL, as to why DRA's proposal to prohibit the Applicants from carrying forward their NOLs, and DRA's gross-up factor method to account for the effects of the Tax Relief Act, should both be rejected.

As for how the calculation of deferred taxes should be done, the Applicants in their reply brief responded to the proposal of TURN and UCAN that the calculation of deferred taxes should include incentive awards and the actual return. We are persuaded by the Applicants' argument that "a utility's actual tax position as reflected on tax returns or FERC forms will not match the income taxes computed as part of a utility's cost of service or GRC revenue requirement." (Applicants Reply Brief at 258.) As the Applicants point out, and as D.84-05-036 recognized, there are a variety of income and deduction items that are not included in the GRC. Thus, including some items in the calculation of

deferred taxes, but excluding other items, would end up in a skewed calculation. Accordingly, the proposal of TURN and UCAN to include incentive awards and actual return in the calculation of deferred taxes is not adopted.

As noted above, SoCalGas proposes to record in rate base a deferred tax asset due to a NOL carry-forward. In D.12-11-051 in SCE's GRC, the Commission declined to allow SCE to record to rate base as an asset the unused deferred tax liability that occurs due to a NOL. In that decision, the Commission concluded as follows:

> We find it is not appropriate to include the NOL in rate base for ratemaking purposes. First, it is a placeholder amount and, second, it would be unfair to ratepayers to essentially pay a carrying charge on SCE's expected future recovery of a tax benefit when the ratepayers have already paid the tax expense in rates.
>
> It is the intent of the Commission that SCE comply with the normalization method of accounting and tax normalization regulations. However, SCE did not provide any statute or regulation which requires the Commission to permit a rate of return on a temporary [Accumulated Deferred Income Tax] asset. SCE may track the NOL, and if SCE later obtains a ruling from the IRS which affirms SCE's position, SCE may file a Tier 2 AL with the Energy Division seeking an adjustment to revenue requirement. (D.12-11-051 at 619.)

We conclude that it is appropriate to treat the Applicants' NOL in a similar fashion. Thus, it is reasonable to allow SDG&E and SoCalGas to apply bonus depreciation to current tax expenses, and to allow SoCalGas to delay recording unused deferred tax liabilities against ratebase until they are used. However, it is unreasonable for SoCalGas ratepayers to provide a rate of return on a deferred tax asset based on a NOL. As a result, the Results of Operations in Attachment B excludes any NOL-based deferred asset from ratebase. To the extent applicable, SDG&E and SoCalGas may file Tier 1 advice letters to create memorandum

accounts to track any NOL that may arise due to bonus depreciation, and either utility may file a Tier 2 advice letter seeking an adjustment to its revenue requirement if an IRS ruling supporting such an adjustment is obtained.

20.5. Franchise Fees

20.5.1. Introduction

The franchise fees cover the "payments made to counties and incorporated cities pursuant to local ordinances granting a franchise to the company to place utility property in the public rights of way." (Ex. 298 at 28; Ex. 300 at 19.) The franchise fees are based on the gross receipts, as described in Exhibits 298 and 300.

20.5.2. Position of the Parties

20.5.2.1. DRA

To compare the forecasts of the Applicants' franchise fees, DRA used a five-year average of 2006-2010. DRA's use of more recent data results in a $796,000 reduction to SDG&E's forecast of electric franchise fees, and no reduction to SoCalGas' forecast.

20.5.2.2. TURN and UCAN

TURN obtained 2010 data regarding SoCalGas' franchise fees. Since that 2010 data has a lower franchise fee percentage than each of the preceding five years, TURN used a five-year average of 2006-2010 to obtain a lower franchise fee percentage. TURN's recommendation to use the lower franchise fee percentage results in a reduction of $130,000.

UCAN obtained 2010 data regarding SDG&E's franchise fees. According to UCAN, the 2010 confirms that SDG&E's forecast of the electric franchise fees is reasonable. However, UCAN contends that the 2010 data shows that gas franchise fees should not be calculated using SDG&E's five-year average of

2005-2009. Instead, UCAN recommends that the gas franchise fees be calculated using the two-year average of 2009-2010 to calculate the gas franchise fees. UCAN's recommendation results in a reduction of $106,000.

20.5.2.3. SDG&E and SoCalGas

Regarding DRA's reduction to SDG&E's forecast of franchise fees, the Applicants contend that DRA's use of 2010 data is inappropriate because it makes an isolated update. The Applicants also contend that DRA's methodology for calculating the annual composite franchise fee rates is flawed because DRA did not account for the timing of when these franchise fees are paid. The Applicants contend that the methodology they used properly matches "the franchise fees expected to be paid in 2012 to the gross receipts that generated those franchise fees." (Ex. 302 at 20.)

The Applicants also oppose TURN's reduction to SoCalGas' forecast of franchise fees, and UCAN's reduction to SDG&E's forecast of franchise fees. The Applicants contend that the use of the 2010 data by TURN and UCAN is inappropriate because it makes an isolated update. The Applicants also contend that UCAN's use of a two-year average to calculate SDG&E's gas franchise fees does not result in more reliable results than a five-year average.

20.5.3. Discussion

We reviewed the testimony and arguments of the parties concerning the forecasts of the franchise fees. Under the circumstances, it is reasonable to use the five-year average that SDG&E and SoCalGas propose to calculate the forecasts of the franchise fees. The use of the five-year average for both SDG&E and SoCalGas provide a uniform approach for forecasting the franchise fees for both utilities.

ATTACHMENT 2

406. It was the Commission that encouraged or required SDG&E to prematurely retire the legacy meters that were replaced by the smart meters.

407. As discussed in the section on rate base issues specific to SoCalGas, it is reasonable to use SoCalGas' five-year average for the forecast of new business forfeitures, and to reduce the number of new regulators by reducing the regulator forecast amount by $700,000.

408. The depreciation section addresses the depreciation expense, amortization expense, and accumulated reserve as applicable to SDG&E and SoCalGas.

409. To derive the depreciation expense for SDG&E and SoCalGas, depreciation studies were prepared.

410. The proposed adjustments to average service lives by TURN and UCAN would have the effect of reducing depreciation expense, which lowers the overall revenue requirement.

411. For the reasons stated in the depreciation section, the average service lives that SDG&E and SoCalGas used are adopted.

412. As discussed in the depreciation section, the arguments of DRA, TURN, and UCAN to change or adjust the future net salvage rates are not supported by the evidence, and are not adopted.

413. The section on taxes addresses payroll taxes, ad valorem taxes, income taxes, and franchise fees.

414. As discussed in the taxes section, it is reasonable to adopt the forecasts of SDG&E and SoCalGas for payroll taxes.

415. As discussed in the taxes section, it is reasonable to adopt the forecasts of SDG&E and SoCalGas for ad valorem taxes.

416. DRA seeks to adjust the income taxes for both SDG&E and SoCalGas because it does not believe they have justified their respective meals and entertainment expense.

417. As described in the taxes section, neither DRA nor the Applicants have fully investigated the meals and entertainment issue, and based on those considerations, it is reasonable to reduce the total income tax expense for SDG&E by $500,000, and for SoCalGas by $500,000.

418. If DRA decides to address the meals and entertainment issue in future GRC applications, that should be raised in connection with the utility's A&G expenses.

419. The Tax Relief Act provides for an extension and enhancement of bonus depreciation for 2010, 2011, and 2012.

420. Bonus depreciation is an additional amount of deductible depreciation that can be taken in an accelerated manner.

421. DRA's gross-up factor, to account for the impact of bonus depreciation, is likely to lead to inaccurate results, as opposed to modeling the bonus depreciation in the Results of Operations model.

422. DRA's proposals to prohibit SoCalGas from carrying forward its NOLs, and to use DRA's gross-up factor method to account for the effects of the Tax Relief Act, are not adopted.

423. As discussed in the taxes section, the proposal of TURN and UCAN to include the incentive awards and actual return in the calculation of deferred taxes is not adopted.

424. It is reasonable to allow SDG&E and SoCalGas to apply bonus depreciation to current tax expenses, and to allow SoCalGas to delay recording unused deferred tax liability against ratebase until they are used.

425. It is unreasonable for SoCalGas' ratepayers to provide a rate of return on a deferred NOL.

426. As discussed in the franchise fees section, it is reasonable to adopt the SDG&E and SoCalGas forecasts of the franchise fees.

427. Miscellaneous revenues are fees and revenues that the Applicants collect from non-rate sources for providing specific products or services, and include service establishment charges, late payment charges, returned check charges, collection fees, and rents.

428. Miscellaneous revenues are used to lower rates by reducing the base margin revenue requirement charged to customers for utility service.

429. As discussed in the SDG&E miscellaneous revenue section, it is reasonable to adopt SDG&E's forecast of the test year 2012 miscellaneous revenues, as adjusted by the increased pole attachment fees of $1.668 million.

430. As discussed in the SoCalGas miscellaneous revenue section, it is reasonable to adopt SoCalGas' forecast of the test year 2012 miscellaneous revenues, as adjusted by the revisions to residential and commercial parts, pipeline services, crude oil sales, and the Federal Energy Retrofit Program.

431. The forecast of customers and sales affects the O&M costs, and capital expenditures.

432. As discussed in the forecast of customers and sales section, it is reasonable to adopt an electric customer forecast for SDG&E of 1,382,924 for 2010, 1,390,866 for 2011, and 1,401,032 for 2012, and the electric sales forecast of SDG&E.

433. As discussed in the forecast of customers and sales section, it is reasonable to adopt SDG&E's gas customer forecast, and sales forecast.