Application of Southern California Gas Company (U904G) for authority to update its gas revenue requirement and base rates effective on January 1, 2012.

Application 10-12-___
Exhibit No.: (SCG-28)

PREPARED DIRECT TESTIMONY OF

RANDALL G. ROSE

ON BEHALF OF SOUTHERN CALIFORNIA GAS COMPANY

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

DECEMBER 2010

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PREPARED DIRECT TESTIMONY
OF RANDALL G. ROSE
ON BEHALF OF SOUTHERN CALIFORNIA GAS COMPANY
(TAXES)

I. PURPOSE

This testimony presents Southern California Gas Company's ("SCG's") estimated tax expense for Test Year ("TY") 2012, and explains how those estimates were derived. SCG incurs three categories of taxes: (1) payroll taxes, (2) ad valorem (i.e., property) taxes, and (3) income taxes. In addition, SCG incurs franchise fees, which it includes in its tax expense estimates. A summary table for each category of tax expense is presented at the end of each section.

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

II. PAYROLL TAXES

A. Introduction

The purpose of this section is to provide an estimate of SCG's 2012 payroll tax expenses, and to describe the methodology used to develop SCG's estimate.

B. Discussion

Payroll taxes were estimated by applying a tax rate on TY 2012 O&M and capital labor covered under this filing up to a maximum wage base. Payroll taxes are paid by both the employee and the employer. The following discussion relates to the employer's payroll tax liability.

1. Federal Insurance Contributions Act ("FICA")

FICA taxes, also referred to as social security taxes, are composed of two pieces: (1) the Old-Age, Survivors, and Disability Insurance ("OASDI") and (2) the Hospital Insurance (Medicare). For 2009, the OASDI tax rate was 6.2% of wages up to a maximum wage base of $106,800. The Medicare tax rate was 1.45% of wages with no maximum wage base. Based on rate schedules contained in the 2009 Annual Report published by the Social Security

Administration (2009 Annual Report), the OASDI and Medicare tax rates have been at current levels since 1990 and are not expected to change through 2012 based on currently enacted law.[1] The OASDI wage base will remain at $106,800 in 2010 and 2011, but is expected to increase to $114,900 in 2012 based on data reported in the 2009 Annual Report.[2]

2. Federal Unemployment Tax Act ("FUTA")

The 2009 FUTA tax rate was 0.8% on wages up to $7,000. Based on currently enacted law, the FUTA tax rate and wage base are not expected to change through 2012.

3. California State Unemployment Insurance ("SUI")

The SUI is composed of two pieces: (1) the Unemployment Insurance ("UI") and (2) the California Employment Training Tax ("CET"). The 2009 UI tax rate was 2.4% on wages up to $7,000. The CET tax rate was an additional 0.1% on wages up to $7,000. Based on currently enacted law, the UI and CET tax rates and wage bases are not expected to change through 2012.

4. Methodology Used to Estimate Tax Expense

Payroll taxes are a function of taxable wages and applicable tax rates. The computation of the estimated payroll taxes begins with the 2009 taxable wages stratified into salary increments. The annual wage base in effect for the year for each type of payroll tax was applied to total wages to ensure that wages up to, but not exceeding, the wage base cap were subject to the tax. Thus, wages up to the salary increment where the annual wage is closest to the wage base cap are subject to the tax. Wages above the wage base cap for any particular type of payroll tax were derived from multiplying the number of employees in each strata above the cap by the wage base cap. The resulting taxable wages for each tax type were totaled and the applicable statutory tax rate was then applied to the total taxable wages. The Medicare portion of the FICA tax is computed without respect to a wage base since all wages are subject to that tax. A companywide composite tax rate was computed based on total forecasted payroll taxes using the above methodology divided by total forecasted wages. The composite payroll tax rate for each year was applied to labor dollars applicable to this filing to determine the employer's payroll tax

[1] See Table VI.F1, Contribution Rates for the OASDI and HI Programs, 2009 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds.
[2] See Table V.C1, 2009 Annual Report.

expense. This methodology is a departure from the methodology employed by SCG to estimate payroll tax expense in prior rate cases and is intended to provide a more granular analysis and a more accurate forecast.

C. Summary of Estimated Payroll Taxes

The summary reflects the amount of payroll taxes on all non-capitalized wages applicable to this filing.

Table SCG-RGR-1

Summary of Estimated Payroll Taxes

(Thousands of nominal $)

Line No.	***Acct. No.***	***2009 Recorded***	***2010 Forecast***	***2011 Forecast***	***2012 Test Year***
1	408	32,256	33,441	35,041	36,781

D. Results

The increase in payroll taxes from 2009 to 2012 reflects the impacts of staffing level changes presented by other witnesses in their direct testimony, the impact of labor cost escalation on those changes, and the increase in the composite payroll tax rate resulting from the OASDI wage base increase as discussed above.

III. AD VALOREM TAXES

A. Introduction

The purpose of this section is to provide an estimate of SCG's ad valorem taxes that will be incurred during TY 2012, and to describe the methodology used to develop the estimate.

B. Discussion

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

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

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

SCG has filed its property statement with the SBE for the 2010 lien date. The property statement forms the basis of the appraisal to set the value of SCG's property for the 2010-2011 fiscal years. The SBE reports the value of property subject to ad valorem tax annually on the "Notice of Unitary Appraised Value," which SCG has received for the 2010-2011 lien date. In correlating the value indicators calculated by the SBE from information contained in the property statement, the SBE applied a weighting of 75% to the HCLD indicator and 25% to the CEA indicator to derive the total appraised valuation of SCG's unitary property.[3] Added to the unitary value of SCG's property is the value of SCG's non-unitary property.[4] In estimating taxes for ratemaking purposes, adjustments were made to exclude taxes resulting from (a) the assessment of non-utility property since it is not included as an operating expense and (b) Construction Work in Process ("CWIP") that gets capitalized rather than directly charged to ad valorem tax expense. In the event the Commission does not approve the request to modify the ratemaking treatment of ad valorem taxes associated with capital construction projects as proposed in the testimony of witness Garry G. Yee (see Exhibit SCG-26), when determining the final revenue requirement for SCG taxes must be recalculated accordingly.

The SBE has followed the same assessment methodology for several years; consequently, SCG followed this methodology to estimate the assessed value for unitary property and the resulting ad valorem tax expense estimate for TY 2012.

The tax rate used to estimate ad valorem taxes is the basic statewide tax rate of 1% established under Proposition 13 plus an additional rate component of 0.2263%, which is a composite rate derived from dividing taxes paid to local jurisdictions by the total assessed value of property in all voter approved local assessment districts (as allowed under Proposition 13). The increase in rates from 2009 to 2012 represents the historical increase in local tax rates. Tax expense for TY 2012 is comprised of the second installment payment from fiscal year 2011 plus the first installment payment for fiscal year 2012.

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

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

C. Summary of Estimated Ad Valorem Tax Expenses

TABLE SCG-RGR-2

Southern California Gas Company

Summary of Estimated Ad Valorem Tax Expenses

(Thousands in nominal $)

Line No.	*Description*		*2009 Recorded*	*2010 Estimated*	*2011 Estimated*	*2012 Test Year*
1	Plant in Service		8,398,831	8,684,222	9,174,179	9,748,341
2	Reserve for Depreciation		(4,758,331)	(4,952,263)	(5,142,740)	(5,344,069)
3	Net Plant		3,640,500	3,731,959	4,031,439	4,404,272
4	Reserve for Deferred Income Taxes		(389,916)	(438,674)	(522,159)	(534,780)
5	Adjustment for Income Approach		(55,987)	44,977	47,927	52,847
6	Assessed Value - Non-Unitary		49,875	52,118	55,536	61,237
7	Assessable Value before adjustment		3,244,472	3,390,380	3,612,744	3,983,575
8	Adjustment due to tax appeal					
9	Net Assessable Value		3,244,472	3,390,380	3,612,744	3,983,575
10	Ad Valorem Tax Rate	x	1.224%	1.230%	1.237%	1.243%
11	Ad Valorem Tax - Fiscal Year		39,697	41,702	44,672	49,519
12	Other Adjustments		(613)	(613)	(613)	(2,517)
	Ad Valorem Tax - Fiscal Yr-Operating		39,084	41,089	44,059	47,001
13	Ad Valorem Tax - Calendar Year*		38,862	40,086	42,574	44,808

*1/2 of the current fiscal year ad valorem tax plus 1/2 of the prior fiscal year ad valorem tax

D. Results

The changes from 2009 to 2012 are the result of changes in plant and depreciation balances presented by other witnesses in their direct testimony and the expected increase in the tax rate for local assessments as discussed above.

IV. INCOME TAXES

A. Introduction

The purpose of this section is to provide an estimate of SCG's income tax expense for TY 2012, and to describe the assumptions and methodology used to calculate income tax expense.

B. Discussion of Income Tax Expense

1. Methodology

SCG operating income is subject to federal income tax and the California Corporation Franchise Tax ("CCFT"). The calculation of ratemaking income taxes is dependent upon federal and state tax laws, prior Commission decisions with general applicability to all utilities, and decisions with specific reference to SCG.

Consistent with Order Instituting Investigation ("OII") 24, Decision ("D.") 84-05-036, the income tax estimates contained in this section are based on SCG's stand-alone taxes, not on an allocation of tax expense from Sempra Energy, the parent company of SCG.[5]

The estimates contained in this section were calculated using current federal and state tax laws enacted through July 30, 2010. SCG has not attempted to forecast future changes in tax law. SCG has utilized current federal and state statutory tax rates of 35% and 8.84%, respectively, in developing its estimate of federal and state income tax expense.

State income tax expense has been computed by reducing operating income by operating expenses, including property taxes and payroll taxes, and making certain permanent and flow through tax adjustments for differences in the book and state tax treatment of items of income and expense (Schedule M adjustments) as explained in more detail later in this section. Consistent with Commission policy, a flow through accounting methodology has been utilized in estimating state tax expense.[6]

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

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[5] 1984 Cal. PUC LEXIS 1325, p. 57-58 (Finding of Fact #12); 15 CPUC 2d 42.

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

Where required, SCG has followed the normalization rules contained in Internal Revenue Code Section ("IRC §") 168 and Treasury Regulations Section ("Reg. §") 1.167(l)-1 in computing federal income tax expense.[7] Accordingly, federal tax depreciation on post-1980 vintage assets has been "normalized" by using a book life and method to calculate tax depreciation. Consistent with Commission policy, where normalization is not required by the IRC, SCG has flowed through tax deductions. For example, tax depreciation on pre-1981 vintage assets has been flowed through as an adjustment to federal tax expense as required by D.93848.[8]

Tax expense based on income has been reduced by the amortization of Investment Tax Credits ("ITC") generated in prior years that were deferred in accordance with SCG's election under applicable tax law[9] to ratably flow through the ITC benefit as a reduction to ratemaking tax expense at a rate not to exceed the book life of the property that generated the ITC. This application conforms to the treatment of deferred ITC amortization mandated by D.88-01-061[10] and is the same treatment employed by SCG in prior rate cases. A small portion of deferred ITC reduced ratebase, pursuant to an election made under applicable law[11] by a predecessor company, Pacific Lighting Gas Supply Company ("Pacific Lighting"), which merged with SCG in November 1985. As a successor in interest, SCG continues to amortize deferred ITC generated by Pacific Lighting as a ratable restoration to rate base.

SCG's federal income tax expense has been reduced by the amortization of remaining excess deferred taxes utilizing the Average Rate Assumption Method ("ARAM") as required by Internal Revenue Service ("IRS") normalization rules and mandated by D.88-01-061.[12]

The Tax Reform Act of 1986 ("TRA 86") adopted rules regarding capitalization of construction period interest for long-lived assets that have an extended construction period. These rules were codified in IRC §263A. For book and ratemaking purposes, construction period interest is capitalized through an allowance for funds used during construction

[7] Normalized tax accounting follows the book treatment for items of income and expense in the revenue requirement calculation.
[8] 1981 Cal. PUC LEXIS 1240; 7 CPUC 2d 332.
[9] SCG's election under former IRC §46(f)(2).
[10] 1988 Cal. PUC LEXIS 102; 27 CPUC 2d 310.
[11] Pacific Gas Lighting's election under former IRC §46(f)(1).
[12] *Id.* at 95-96.

("AFUDC"). While similar in concept, there are specific differences between the book and tax treatment of construction period interest. As in prior rate cases, for tax purposes, SCG follows the rules in IRC §263A in this filing with respect to the capitalization of construction period interest.

As prescribed by the Commission, SCG used the statutory federal tax rate of 35% and the statutory state tax rate of 8.84% in development of the net-to-gross multiplier used to gross-up tax expense to a revenue requirement.[13]

2. Schedule M Items and Other Specific Tax Deductions

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

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

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

Fiscal Year/Calendar Year Property Tax Adjustment. An adjustment is made to add back calendar-year property tax expense per books and deduct fiscal-year property tax expense as allowed by federal and state tax law. SCG has flowed through the fiscal year tax expense as a deduction in calculating tax expense.

Prior Year CCFT. Federal law allows a deduction for state income taxes paid. In California, this is the CCFT deduction. However, for ratemaking purposes, D.89-11-058[14] specifies that the allowable deduction is the prior years' Commission-adopted CCFT, not the

[13] *Supra* at 62-63 (Conclusion of Law #9).
[14] 1989 Cal. PUC LEXIS 815, p. 34 (Conclusion of Law #1); 33 CPUC 2d 495.

current year CCFT. Since there is, as yet, no Commission-adopted CCFT, SCG has used the prior year's CCFT estimate in calculating federal tax expense for TY 2012.

Internally-Developed Software. For financial accounting purposes, software expenses are capitalized and amortized over various lives. For tax purposes, a current year deduction is allowed under IRC §174 for internally-developed software costs.[15] SCG has flowed through the deduction for internally-developed software expenditures. Un-modified, or "canned," software must be capitalized and amortized under IRC §167(f).[16] SCG has normalized the deduction for capitalized software pursuant to D.84-05-036.[17]

Non-Deductible Meals. Federal and state tax laws limit the deduction for meals and entertainment to 50% of the actual costs incurred. Consequently, SCG must add to taxable income 50% of meals and entertainment expense deducted for financial reporting purposes. SCG's 2012 Schedule M tax adjustment is based on a trend of actual tax return experience in prior years.

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

State Tax Depreciation. California did not adopt the federal accelerated depreciation ACRS and MACRS methods and lives or the normalization requirements enacted by the Economic Recovery Tax Act of 1981 ("ERTA") and the TRA 86. Accordingly, there is no requirement to normalize state tax depreciation; therefore, SCG flows through the state tax depreciation in excess of the book amount. SCG's state tax depreciation is calculated using the

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[15] The 2012 tax deduction for internally-developed software is a function of the forecasted spend on internally-developed software in TY 2012. Spend data is forecasted by capital witnesses in the rate base module and the tax module pulls in the forecasted spend data from the rate base module. A formula error was discovered in the Results of Operations model that caused the TY 2012 forecast of internally-developed software to be understated. Because this error was discovered after the model's output was finalized, SCG will seek to correct this error in a subsequent submittal (e.g., errata).

[16] IRC Section 167(f) required capitalization of un-modified software purchased after August 10, 1993.

[17] *Supra*.

Asset Depreciation Range Method ("ADR") prescribed by the IRS prior to 1981, which utilizes double declining balance depreciation switching to a straight-line method when book depreciation exceeds the double declining balance method.

Federal Cost of Removal. SCG follows the guidance in IRS Revenue Ruling 2000-7, which provides a current deduction for actual costs to remove assets retired from service. However, under the normalization rules, costs to remove assets that have been depreciated using either Accelerated Cost Recovery System ("ACRS") or Modified Accelerated Cost Recovery System ("MACRS") cannot be flowed through. Accordingly, federal removal costs are deducted only on pre-1981 vintage assets retired from service. This decision is consistent with D.93848.

State Cost of Removal. California did not adopt the federal ACRS or MACRS depreciation systems, choosing instead to remain on the ADR system. Accordingly, SCG flows through removal costs without regard to the vintage of the underlying assets per D.84-05-036.[18]

Federal Percentage Repair Allowance. As noted above, SCG depreciates its pre-1981 vintage assets under the ADR system of depreciation. Under this election, SCG is entitled to take a current deduction for a specified percentage of capitalized book repairs related to ADR property. SCG has flowed through this deduction in accordance with D.93848.

State Percentage Repair Allowance. California did not adopt the federal ACRS or MACRS tax depreciation systems, therefore, the ADR tax depreciation system continues in use for all vintages of property for California depreciation purposes. Accordingly, SCG is entitled to take a current deduction for a specified percentage of capitalized book repairs without limitation based on the vintage of property. Consistent with D.93848, SCG has flowed through this deduction.

C. Discussion of Deferred Taxes

The accumulated deferred federal income tax ("ADFIT") resulting from the difference between normalized tax depreciation computed using a book life and method and the comparable tax depreciation computed using ACRS or MACRS depreciation methods has been included as an adjustment to rate base in this General Rate Case ("GRC") (see the testimony of Garry G.

[18] *Supra* at 59 (Finding of Fact #23).

Yee, Exhibit SCG-26, for a discussion of rate base). SCG's treatment of deferred taxes is in accordance with IRC §168(i) (9), Reg. §1.167(l)-1, and related IRS rulings.[19]

All current law has been followed in the development of deferred federal income taxes. The most significant recent change in law affecting deferred taxes is the expiration on January 1, 2005 of the 30% and 50% bonus depreciation provisions enacted by the Job Creation and Worker Assistance Act of 2002 and the Jobs and Growth Tax Relief Act of 2003, respectively.

Accordingly, except in the case of certain qualified self-constructed assets placed in service in 2005, bonus depreciation has not been calculated on property placed in service between January 1, 2005 and December 31, 2007 when bonus depreciation was not allowed. The residual impact of bonus depreciation taken on qualified property placed in service in prior periods is reflected in the accumulated deferred income tax balances for 2009-2012.

Since the effective date of SCG's 2008 GRC decision, Congress has passed three major pieces of legislation with tax implications for SCG's 2012 TY estimates.

- The Economic Stimulus Act of 2008 (2008 Act) included a provision that allowed enhanced 50% bonus depreciation on the acquition cost of qualified property, with a recovery period of 20 years or less that got placed in service in 2008.
- The American Recovery and Reinvestment Act of 2009 (2009 Act) included a one year extension of 50% bonus depreciation for qualified property placed into service before 1/1/2010.
- The Small Business Jobs Act of 2010 (2010 Act) included another one-year extension of bonus tax depreciation for qualified property placed in service before January 1, 2011.

The ratemaking effect of these three Acts was to increase federal tax return depreciation in 2008, 2009, and 2010 above the regular tax depreciation provided by the federal MACRS depreciation system. The extra bonus tax depreciation allowed by the Acts created additional deferred taxes equal to the extra bonus depreciation multiplied by the 35% federal income tax rate. The additional deferred taxes created by bonus depreciation in 2008, 2009, and 2010 are reflected in the accumulated deferred tax balances for purposes of calculating rate base for TY 2012.

[19] IRC §168, Reg. §1.167(l)-1, and numerous IRS rulings make up the "tax normalization" requirements.

Contributions-in-aid-of-construction ("CIAC") became taxable under the TRA 86. Pursuant to D.87-09-026, SCG elected Method 5 to account for the tax impacts of CIAC, and the related income tax component of the contribution ("ITCC") as required by the TRA 86. In accordance with the decision, SCG has increased rate base for the tax paid on CIAC and its related ITCC received subsequent to February 10, 1987, the date that CIAC became taxable under the TRA 86. The increase to rate base related to CIAC tax impacts is reversed through tax depreciation over the tax life of the constructed property. The increase to rate base related to ITCC tax impacts is reversed through the amortization of ITCC to miscellaneous revenue over the tax life of the constructed property.

ITCC represents the tax gross-up for CIAC. It also became taxable under TRA 86. These tax gross-up amounts reflect the present value of tax paid upon receipt of CIAC, less the future tax benefits to be received through tax depreciation over the tax life of the constructed property. ITCC is included as a reduction to rate base and is amortized to miscellaneous revenue over the tax life of the constructed property as instructed by D.87-09-026.[20]

Accumulated deferred taxes for TY 2012 were developed on a monthly basis and prorated in accordance with the normalization requirements of Reg. §1.167(l)-1(h)(6)(ii).[21]

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[20] 1987 Cal. PUC LEXIS 195; 25 CPUC 2d 299.

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

D. Summary Tables

TABLE SCG-RGR-3-1

Southern California Gas Company

Calculation of Federal & State Income Taxes

($ in Thousands)

Line No	*Description*		*2009 Recorded*	*2010 Estimated*	*2011 Estimated*	*2012 Test Year*
1	Total Operating Revenue (Table 24, Line 1)		1,660,939	1,783,681	1,932,250	2,124,310
2	O&M Expenses (Table 24, Line 2)		(983,427)	(1,057,316)	(1,140,041)	(1,213,927)
3	Taxes Other than Income Taxes (Table 24, Line 3)		(71,118)	(73,527)	(77,615)	(81,588)
4	Book Income Before Depr. & Income Taxes		606,394	652,838	714,594	828,794
5	State Tax Adjustments (Table 24, Line 5)		(486,035)	(525,032)	(560,821)	(572,330)
6	Taxable Income		120,359	127,806	153,773	256,464
7	CCFT Rate	x	8.84%	8.84%	8.84%	8.84%
8	**California Corporate Franchise Tax**		10,640	11,298	13,594	22,671
9	Book Income Before Depr. & Income Taxes (Line 4, above)		606,394	652,838	714,594	828,794
10	Federal Tax Adjustments (Table 24, Line 10)		(427,848)	(430,445)	(461,753)	(481,001)
11	Taxable Income		178,546	222,393	252,841	347,793
12	Federal Income Tax Rate	x	35%	35%	35%	35%
13	Federal Income Tax Before Credits		62,491	77,838	88,494	121,728
14	Investment Tax Credit Amortization		(2,617)	(2,559)	(2,508)	(2,426)
15	Average Rate Assumption Method (ARAM)		(195)	(195)	(195)	(195)
16	Other		(797)	(797)	(797)	(797)
17	**Total Federal Income Tax**		58,882	74,287	84,995	118,310

TABLE SCG-RGR-3-2

Southern California Gas Company

Summary of Income Tax Adjustments

($ in Thousands)

Line No.	*Description*	*2009 Recorded*	*2010 Estimated*	*2011 Estimated*	*2012 Test Year*
	Federal Tax Adjustments:				
1	Tax Depreciation	(224,206)	(239,680)	(271,627)	(310,490)
2	Fixed Charges – Operating	(89,863)	(93,896)	(100,934)	(116,188)
3	Cost of Removal	(3,917)	(5,386)	(5,386)	(5,386)
4	Percentage Repair Allowance	(16,340)	(15,293)	(15,293)	(15,293)
5	Prior Year Calif. Corp. Franchise	(23,249)	(10,640)	(11,298)	(13,594)
6	Software Dev	(70,745)	(65,345)	(56,527)	(18,655)
7	50% of Meals & Entertainment	414	517	517	517
8	Ad Valorem Tax - Fiscal/Calendar	(222)	(1,003)	(1,485)	(2,194)
9	Preferred Dividend	280	280	280	280
10	Total Federal Tax Adj. (Deduction)	(427,848)	(430,445)	(461,753)	(481,001)
	State Tax Adjustments				
11	Tax Depreciation	(270,337)	(308,442)	(345,450)	(378,791)
12	Fixed Charges – Operating	(88,988)	(93,103)	(100,220)	(115,550)
13	Cost of Removal	(11,423)	(12,792)	(12,792)	(12,792)
14	Percentage Repair Allowance	(44,217)	(44,347)	(44,347)	(44,347)
15	Software Dev	(70,745)	(65,345)	(56,527)	(18,655)
16	50% of Meals & Entertainment	414	517	517	517
17	Ad Valorem Tax - Fiscal/Calendar	(222)	(1,003)	(1,485)	(2,194)
18	Preferred Dividend	(517)	(517)	(517)	(517)
19	Total State Tax Adj. (Deduction)	(486,035)	(525,032)	(560,821)	(572,330)

E. Results

The increase in federal and state tax expense from 2009 to TY 2012 is primarily a function of increasing book income before taxes resulting from the return on a growing rate base. Federal and state tax adjustments are also growing annually, partially offsetting the growth in book income before taxes from 2009 to TY 2012.

V. FRANCHISE FEES – ACCOUNT 927

A. Introduction

The purpose of this section is to provide background and analysis for SCG's franchise fees as estimated for TY 2012.

B. Discussion

Franchise fees are payments made to counties and incorporated cities pursuant to local ordinances granting a franchise to the company to place utility property in the public rights of way. These facilities include pipes and appurtenances for transmitting and distributing gas. As of January 1, 2009, SCG had franchise fee agreements with 242 taxing jurisdictions.

The franchise fee requirements are based upon gross receipts representing the recovery of base margin. The franchise factor upon which the estimated 2010-2012 franchise fees were determined is based on a summary of 2009 gas sales, transportation revenues, rate refunds, state fees, uncollectibles, and miscellaneous service receipts. The factor was adjusted to 2012 using historic trends in franchise payment data and by factoring in expectations of future franchise fee rates.

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

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

The total payments to all taxing authorities were summed and divided by total receipts to arrive at a systemwide franchise fee factor. The systemwide franchise fee factors for the most recent five years were then averaged to yield a forecasted average franchise fee factor for TY 2012. The average franchise fee factor was adjusted to incorporate a forecasted increase in the Los Angeles County franchise fee that expires in 2011 and will be renewed for 2012 and beyond. We have not included any potential granting fees in the projected 2012 franchise fee factor that could be imposed on SCG during upcoming negotiations with Los Angeles County. In the event that the negotiations result in the imposition of a granting fee after the GRC application is filed, but before the update filing, the granting fee will be capitalized and SCG will propose an amortization of the granting fee to be included in the franchise fee factor in the update filing. In addition, the City of Huntington Beach implemented a franchise fee surcharge on customers located in the City beginning in 2010 that resulted in a decrease to the systemwide franchise fee factor. The average franchise fee factor for 2012 is projected to be 1.4593%.

Table SCG-RGR-4-1 below provides the detail for Account 927, Franchise Fees as estimated for the 2012 TY.

C. Summary of Estimated Franchise Fees

Table SCG-RGR-4-1

($ in thousands)

Line No.	*Acct. No.*	*Title*	*2009 Recorded*	*2010 Forecast*	*2011 Forecast*	*2012 Test Year*
1	927	Franchise Fees	23,194	24,644	26,598	29,895

D. Results

The change in franchise fee expense from 2009 to 2012 results from changes in base margin as presented by other witnesses in their direct testimony, the increase to the franchise fee factor due to the renewal of the Los Angeles County franchise, partially offset by the impact of the surcharge adopted by the City of Huntington Beach.

This concludes my prepared direct testimony.

VI. WITNESS QUALIFICATIONS

My name is Randall G. Rose. I am employed by Sempra Energy as a Tax Director responsible for tax operations on behalf of San Diego Gas & Electric Company ("SDG&E") and Southern California Gas Company ("SCG"). My business address is 101 Ash Street, HQ-07, San Diego, California 92101. I direct the preparation of SCG's federal and state income tax returns and the tax adjustments reflected in the accounting for income taxes. I am also responsible for the development and analysis of payroll tax estimates, income tax estimates, ad valorem tax estimates, and franchise fee estimates for use in SCG's ratemaking proceedings.

I received a Bachelor of Science Degree Business Administration with an emphasis in Accounting from San Diego State University. I am a Certified Public Accountant licensed by the State of California.

Prior to being employed by Sempra Energy, I was employed by SDG&E as the Property Tax Administrator. Before joining SDG&E, I was a senior tax advisor to the elected member of the California State Board of Equalization from the 3rd Equalization District. In that function, I advised the Board Member on tax appeals cases and utility ad valorem assessments that came before the Board for a decision.

I have previously testified before this Commission.