Docket:	:	A.12-12-024
Exhibit Number	:	DRA-08
Commissioner	:	Sandoval
ALJ	:	Kim
Witness	:	Loy

DIVISION OF RATEPAYER ADVOCATES
CALIFORNIA PUBLIC UTILITIES COMMISSION

Report on the Results of Operations for Southwest Gas Corporation General Rate Case
Test Year 2014

Tax Expenses

San Francisco, California
June 3, 2013

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SOUTHWEST GAS CORPORATION
TAX EXPENSES

I. INTRODUCTION

This exhibit presents the Division of Ratepayer Advocates' (DRA) analyses and recommendations regarding Southwest Gas Corporation's (U905G) (SWG) proposed tax expenses of its three California service territories for Test Year (TY) 2014.

Ratemaking taxes are comprised of the following: (1) Federal Income Taxes (FIT); (2) State Income Taxes, or the California Corporation Franchise or Income Taxes (CCFT); (3) payroll taxes; (4) property, or *ad valorem*, taxes; (5) franchise fees; and (6) deferred taxes. Ratemaking tax expenses are the product of projected income or revenue streams, ratemaking expenses including qualifying payroll and taxable property values. Additionally, revenue requirements are calculated to ensure that regulatory tax policies and practices are in accord with the relevant Internal Revenue Code. Under this construct, expenditures that may qualify as a deduction for tax purposes may not be allowed for ratemaking purposes as a cost of service. In other cases, certain balance sheet timing differences between when a deduction is claimed for tax purposes and when it is expensed as a cost of service are accounted for and reflected in the rate base component of the revenue requirement.

To the extent that the California Public Utilities Commission (Commission) adopts cost of service amounts of expenses and/or capital that differ from those DRA or SWG are proposing, taxes would need to be recalculated to reflect the impact of the changed values.

II. SUMMARY OF RECOMMENDATIONS

The following summarizes DRA's recommendations regarding SWG's Application for TY 2014:

- For CCFT, use the effective tax rate calculated for each Division, because the statutory rate was rejected for ratemaking purposes in multi-state jurisdictions by the Commission in D.84-05-036.
- For property taxes, adopt DRA's adjustments to the Northern California and Southern California Divisions to reflect (i) the California State Board of Equalization's assessed value which is used to determine property taxes; and (ii) recent trends in tax rates for the Southern California Division.
- Adopt DRA's adjustments to SWG's deferred taxes to reflect (i) the 2013 Bonus Depreciation statutory rates set forth in the American Tax Relief Act of 2012[1]; and (ii) DRA's projections of net plant additions.
- For deferred taxes, the Commission should reject SWG's inclusion of net operating losses from its parent company via common or "System" allocations.[2]

III. DISCUSSION / ANALYSIS

Taxes are a function of current federal, state, and local tax laws, including new laws expected to affect the Test Year, and regulatory tax policies. The Commission established many of its existing tax policies and practices in the proceeding *Re Income Tax Expense for Ratemaking Purposes*, D.84-05-036.[3] Most significantly, in D.84-05-036, the Commission affirmed a generic flow-through policy to the extent permitted by law and the use of a stand-alone regulated utility basis. Numerous subsequent decisions adopted a variety of changes in ratemaking tax policies in order (i) to correct a specific rate setting practice; (ii) to comply with the Internal Revenue Code and changes in federal and state tax laws; and/or (iii) when to use normalization for ratemaking purposes, such as the following: D.87-09-026, D.88-01-026, D.88-01-061, D.98-11-058 and D.90-12-034.

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[1] Pub. L. 112–240, H.R. 8, 126 Stat. 2313, enacted January 2, 2013**.**

[2] *Income Tax Expense*, D.84-05-036, 1984 Cal. PUC LEXIS 1325. At **47–48 (dated May 2, 1984).

3 *Id.*

Typically, a utility is part of a combined group of corporations, which files a consolidated income tax return with the Internal Revenue Service and another consolidated tax return with appropriate state agencies. In this regard, SWG is a multi-state corporation and its three California Divisions are part of a consolidated group including affiliates.

A. Federal Income Tax Rate

DRA finds that SWG's statutory rate and tax calculations are reasonable with the following exceptions:

- American Tax Relief Act of 2012 and 2013 Bonus Depreciation rates; and
- DRA plant in-service adjustments.

See Subsection F. Deferred Taxes below for details and results.

B. California State Income Tax Rate

DRA recommends using "the utility's effective tax rate"[4] to compute CCFT for ratemaking purposes. SWG is using the same California statutory rate of 8.84% for each of its three Divisions.[5] In D.84-05-036, the Commission continued its policy of using the utility's effective CCFT tax rate under "the unitary method" to forecast ratemaking CCFT for those utilities having multi-state operations.[6] The Commission also explicitly rejected the statutory rate proposal.[7] Therefore, SWG's use of the statutory rate is not permitted for ratemaking.

DRA derived the effective CCFT tax rate for each Division using the 2011 recorded (i) tax expense; and (ii) net operating income before taxes taken from DRA's Results of Examination(DRA-10).[8] Table 8-1 below displays the effective CCFT rates DRA used in its RO model.

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[4] *Id.*

[5] "Form 100 Booklet 2012," p. 6, "B. Tax Rates;" California Franchise Tax Board. https://www.ftb.ca.gov/forms/2012/100_table_of_contents.shtml?WT.mc_id=Business_Forms_CorpTOC

[6] *Id.* at *47.

[7] *Id.* at *48.

[8] Excel file: "DRA-SWG-Audit-2_GN-1."

Table 8-1
Comparison of DRA's Effective Tax Rates to SWG's Statutory Tax Rate

Division	DRA	SWG	SWG Exceeds DRA	
			Difference	Percent
Southern California	7.6034%	8.840%	1.237%	16.26%
Northern California	6.5394%	8.840%	2.301%	35.18%
South Lake Tahoe	6.0844%	8.840%	2.756%	45.29%

Sources: DRA Results of Examination, Excel file: "DRA-SWG-Audit-2_GN-1" or California Franchise Tax Board's "Form 100 Booklet 2012," pg. 6.

C. Payroll Taxes

In this Application, SWG uses the most recent statutory rates and wage bases for the Federal Insurance Contribution Act, Medicare, Federal Unemployment Insurance, California State Unemployment Insurance, and Nevada State Unemployment Insurance. For the purposes of this rate case, DRA takes no issue with SWG's payroll tax rates and method (with the exception of using DRA's payroll expense level).

D. Property Taxes

DRA reviewed SWG's property tax method on a recorded basis to determine the accuracy and reasonableness of SWG's forecasts. SWG is using its projections for plant additions as a direct substitute for California Board of Equalization (BOE) "allocations of the assessed value of state-assessed property"[9] to forecast property taxes. For the Northern California Division and Southern California Division, these different property valuations are not reasonable substitutes. (*See* Tables 8-2 and 8-3 below.) Specifically, SWG's use of net plant will overestimate property taxes, because it is from 107% to 135% higher than the BOE's assessed property value. For property tax rates, SWG assumed that tax rates always increase. Table 8-4 and Graph 8-1 below demonstrate that an increasing tax rate assumption is not the case for the Southern California Division because it has stabilized. For these reasons,

[9] *See* SWG response to DRA Data Request DRA-SWG-MRL and SWG work paper spreadsheet "16 Prop Tax."

DRA has concluded that SWG's proposals for Northern and Southern California Divisions are inaccurate and biased.

Table 8-2
Northern California Division
SWG's Property Valuation Exceeds the BOE's

Lien Date 1/1/Year	SWG Net Plant 12/31/Previous Year	SWG Exceeds BOE	**BOE** AAVSA Value
(a)	(b)		(c)
Source: SWG WP "16 Prop Tax" and DR MRL-1-4 Attachment 1			
2007	$55,811,891	115.29%	$48,409,123
2008	56,928,908	117.40%	48,492,689
2009	59,003,613	119.87%	49,221,919
2010	60,578,611	117.61%	51,507,852
2011	62,601,665	132.13%	47,380,370
2012	64,234,526	138.93%	46,236,575

Table 8-3
Southern California Division
SWG's Property Valuation Exceeds the BOE's

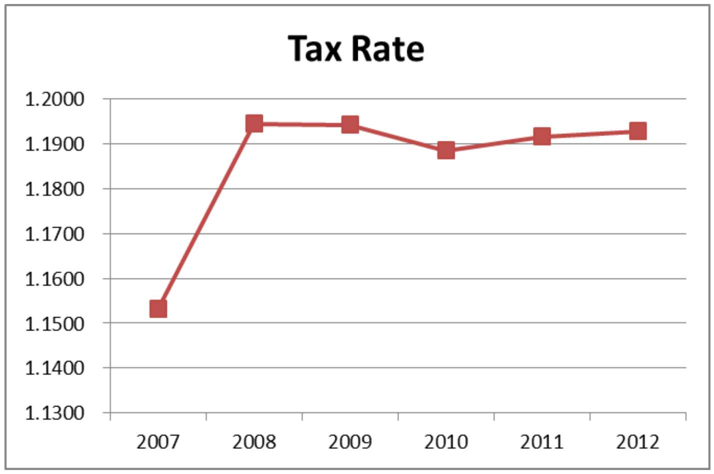
Lien Date 1/1/Year		SWG Net Plant 12/31/Previous Year	SWG Exceeds BOE	BOE AAVSA Value
(a)		(b)		(c)
Source: WP "16 Prop Tax" and DRA SWG DR MRL-01 4 Attachment 3 updatec				
2007	$	135,276,469	103.48%	130,731,648
2008	$	149,945,262	108.08%	138,732,562
2009	$	153,075,428	108.07%	141,643,512
2010	$	151,867,181	103.47%	146,780,185
2011	$	149,456,345	100.70%	148,412,034
2012	$	159,400,456	107.70%	147,998,124

Southern California Division
SWG's Increasing Property Tax Rate Assumption is Not Reasonable

Table 8-4

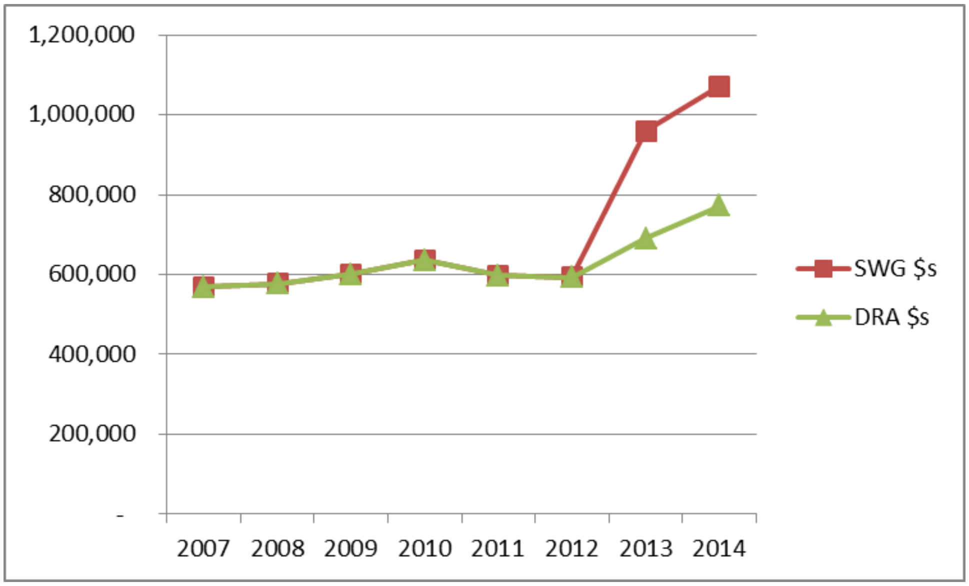
Year	Tax Rate/$100
2007	1.1532
2008	1.1944
2009	1.1943
2010	1.1885
2011	1.1917
2012	1.1928
6 Yr Average	1.1858
5 Yr Average	1.1923

Graph 8-1

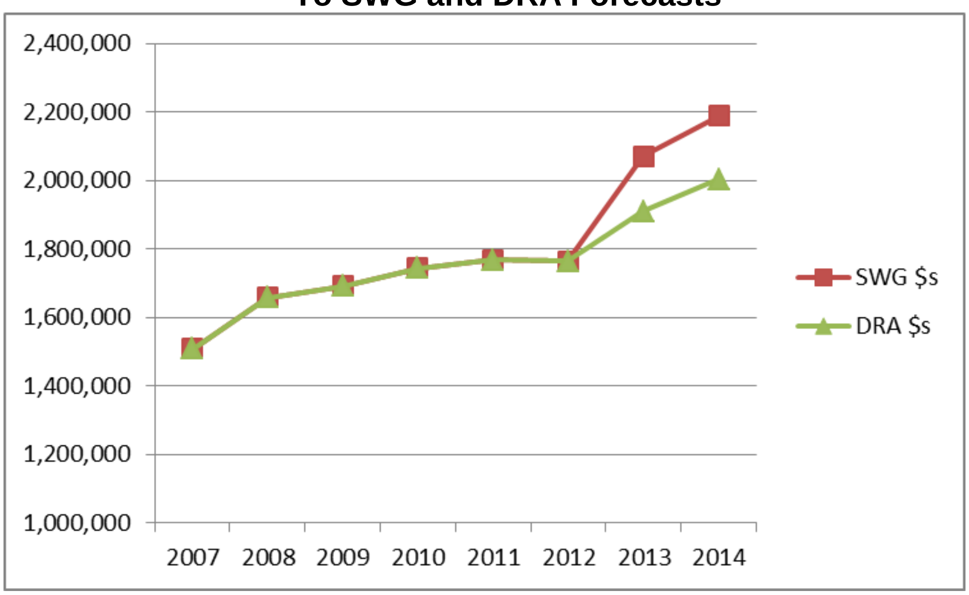


Based its findings stated above, DRA developed its own forecasting methods for Northern and Southern California Divisions. DRA does not take issue with SWG's proposal for South Lake Tahoe. To correct for using net plant instead of BOE's assessed value, DRA constructed an adjustment factor that scales the forecast of BOE assessed property value relative to the level of the net plant forecast. In place of SWG's assumption of increasing rates for Southern California, DRA used a five-year average of 1.1923. (*See* Table 8-4 below). A comparison of the historical tax liability with SWG's and DRA's projections is shown in Graphs 8-2 and 8-3. These graphs show DRA's forecast is in accord with the recent historical trend while SWG's forecast is well above this trend.

Graph 8-2
Northern California Division
Property Taxes Comparison of Historical Trend
To SWG and DRA Forecasts



Graph 8-3
Southern California Division
Property Taxes Comparison of Historical Trend
To SWG and DRA Forecasts



E. Franchise Taxes

DRA analyzed SWG's franchise tax projections based on a review of each and every franchise agreement and confirmed SWG used the appropriate franchise rate. For the purposes of this rate case, DRA finds SWG's proposed franchise rates and method, excluding revenues, reasonable.

F. Deferred Taxes

DRA made three adjustments to SWG's proposals for Deferred Taxes. First, DRA removed SWG's inclusion of consolidated losses from its parent company. Next, for depreciation, the federal depreciation rates were updated to reflect Bonus Depreciation for 2013 and as expected for 2014. Third, DRA replaced capital additions to reflect DRA's projections of net plant. These issues are discussed in more detail below.

DRA recommends the Commission adopt DRA's adjustment to SWG's 2013 and 2014 Federal deferred taxes to reflect the 2013 Bonus Depreciation statutory rates set forth in the American Tax Relief Act of 2012.[10] Although, these new Bonus Depreciation rates were not passed when SWG filed this Application, they were passed in late 2012 and are in effect for 2013 and, given the state of the economy and legislative history enacting Bonus Depreciation, as expected for 2014. Also, DRA scaled the annual changes in deferred federal taxes for both in-state and common plant additions to incorporate the impact of DRA's projections of net plant additions with these new Bonus Depreciation rates.

For deferred taxes, DRA recommends the Commission reject SWG's inclusion of net operating losses from its parent company via common or "System" allocations because: (i) the parent company's operations on a consolidated basis, not common plant, generated these losses; and (ii) the Commission has ruled that ratemaking taxes are calculated on a "stand-alone" basis to exclude consolidated losses or gains.[11] If decision-makers were to adopt SWG's logic, then consolidated gains would be ripe for allocation to California ratepayers as well. For these

[10] Pub.L. 112–240, H.R. 8, 126 Stat. 2313, enacted January 2, 2013.

[11] D. 84-05-036, *supra* note 2.

reasons, DRA recommends that the Commission continue its policy of “stand alone” tax basis by excluding the losses (and gains) of corporate parents, affiliates, and subsidiaries.

IV. QUALIFICATIONS OF WITNESS

Q.1 Please state your name and address.

A.1 My name is Mark Robert Loy. My business address is 505 Van Ness Avenue, San Francisco, California.

Q.2 By whom are you employed and in what capacity?

A.2 I am employed by the California Public Utilities Commission as a Public Utilities Regulatory Analyst V in the Division of Ratepayer Advocates Energy Cost of Service and Natural Gas Branch.

Q.3 Briefly describe your educational background and work experience.

A.3 I earned a Bachelor of Arts degree in Economics from the University of California at Santa Cruz in 1980. While attending the University I was employed as a teacher assistant and as a research assistant. After graduation, I worked as an accountant for a partnership of Certified Public Accountants. In 1982, I joined the California Public Utilities Commission. Initially, I was assigned to the economics department. Most of my work there concentrated on telecommunication and energy general rate case proceedings. Presently, I am assigned to the Division of Ratepayer Advocates.

My primary responsibilities in the past have been to review, investigate, analyze, and make recommendations in such areas as cost-benefit analysis, financial analysis, capital additions and expense forecasting, labor inflation, non-labor inflation, econometric forecasting, and pensions and benefits expenses. I have prepared, sponsored, and presented direct testimony on cost-benefit analysis, capital additions and expense forecasting, decommissioning expenses and financing, labor inflation, non-labor inflation, sales and revenues, and pensions and benefits expenses in various proceedings of all major California energy, telecommunications, and water utilities.

Q.4 What is your area of responsibility in this proceeding?

A.4 I am responsible for Exhibit DRA-08, Tax Expenses.

Q.5 Does that complete your prepared testimony?

A.5 Yes, it does.