STATE OF NEW JERSEY

BOARD OF PUBLIC UTILITIES

In The Matter of the Petition of
Public Service Electric and Gas Company
for Approval of an Increase in Electric and Gas
Rates and For Changes In the Tariffs For Electric
And Gas Service, B.P.U.N.J. No. 16 Electric and
B.P.U.N.J. No. 16 Gas Pursuant to
***N.J.S.A.* 48:2-21 and *N.J.S.A*. 48:2-21.1,**
And For Other Appropriate Relief

BPU Docket Nos. ER18010029 & GR18010030

DIRECT TESTIMONY
OF
ROBERT C. KRUEGER, JR.
12+0 UPDATE

VICE-PRESIDENT – SPECIAL PROJECTS
PSEG SERVICES COMPANY

August 8, 2018
P-4 R-2

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Robert C. Krueger, Jr. My business address is 80 Park Plaza, Newark, New Jersey.

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

A. I am employed by PSEG Services Company as Vice-President – Special Projects. My professional credentials are included as Schedule RCK-1.

Q. What is the purpose of your testimony?

A. In this case, I am testifying on behalf of Public Service Electric and Gas Company ("PSE&G", "Public Service", or the "Company"). The purpose of this testimony is to present and support tax expense and accumulated deferred income taxes ("ADIT"), and to address several tax issues arising in the filing including those raised by the passage of Tax Cuts and Jobs Act of 2017 ("the Act"). Given the significant impacts of the Act, the Board of Public Utilities ("Board") Order in Docket No. AX18010001 addressing the Act, and the impacts of these developments on the Company's original filing, this testimony serves as a complete replacement to the original version submitted on January 12, 2018, as well as the 9+3 update testimony submitted on May 14, 2018. The purpose of my testimony is to:

- summarize the impact of the Act on this filing;
- present current and deferred tax expense included in test period results, including a modification from historical practice in this determination;
- present ADIT attributable to utility rate base. In this regard, my testimony will support and supplement the testimony of Mr. Scott Jennings, PSE&G's Vice President – Utility Finance on these matters; and
- discuss the consolidated tax ratemaking adjustment ("CTA") and present a computation of that adjustment that is consistent with the Board decision in *I/M/O the Verified Petition Of Jersey Central Power & Light Company For Review and Approval of Increases In And Other Adjustments To Its Rates And Other Charges For Electric Service,* BPU Docket No. ER12111052, Order Adopting Initial Decision With Modifications and Clarifications (March 26, 2013), at page 73.

Q. Do you sponsor any schedules as part of your prepared testimony?

A. Yes. I sponsor the following schedules that were prepared or compiled under my direct supervision – these Schedules supersede the Schedules submitted with my original 5+7 and 9+3 testimonies:

- Schedule RCK-1 describes my professional qualifications and business experience;
- Schedule RCK-2 R-2 details the calculation of protected and unprotected excess deferred taxes as a result of tax reform;

- Schedule RCK-3 R-2 details the computation of income tax expense for electric and gas for the test year;

- Schedule RCK-4 R-2 details the computation of accumulated deferred income taxes for electric and gas for the test year;

- Schedule RCK-5 R-2 details two adjustments associated with the Company's proposal to flow-through to customers the tax benefit associated with the Safe Harbor Adjusted Repair Expense ("SHARE") deductions, and several pro forma adjustments to income tax expense;

- Confidential Schedule RCK-6A R-2 details the computation of the CTA;

- Confidential Schedule RCK–6B R-2 details the computation separating transmission taxable income from electric taxable income;

- Schedule RCK-7 R-2 details the computation of the offset of certain regulatory assets by unprotected excess deferred income taxes; and

- Schedule RCK-8 sets forth the Company's response to various data requests in this proceeding.

II. <u>THE IMPACT OF FEDERAL TAX LEGISLATION</u>

Q. What are the implications of the Act?

A. The Act contains provisions that substantially modify the Internal Revenue Code. The Act impacts utility rates in the following respects:

- The Act reduces the maximum federal corporate tax rate from 35% to 21% effective, January 1, 2018.
- The Act has a provision that controls the pace at which excess deferred taxes related to accelerated depreciation resulting from the federal corporate tax rate change may be returned to utility customers. Specifically, it provides that

these excess deferred taxes may be returned no more rapidly than under the Average Rate Assumption Method ("ARAM").

- The Act limits the deduction of business interest; however, regulated utilities are exempt from this provision.
- The Act allows for 100% bonus depreciation for capital additions incurred or committed after September 27, 2017. However, regulated utilities that are exempt from the interest deduction limitations are also not permitted to deduct bonus depreciation. There are transition rules that may allow bonus depreciation on certain capital additions after that date.
- The Act expands the disallowance of the deduction for compensation in excess of $1 million by removing the exception for performance based compensation, by expanding the definition of covered employee to include the Chief Financial Officer, and requiring the status as covered employee to continue for life.

There are other relevant provisions in the Act, but these are the most significant.

Q. Please describe the implications of the reduction in the federal corporate income tax rate on tax expense and operating income and how customers will be provided any savings.

A. The Act reduced the federal corporate income tax rate from a maximum of 35% to 21%, effective January 1, 2018. This rate change reduced PSE&G's tax expense beginning January 1, 2018. This reduction in tax expense creates a built-in over-collection in current rates. Pursuant to the Board's Order in Docket No AX18010001, the Company reduced its rates effective April 1, 2018 to eliminate this over-collection and further, the Company has deferred the over-collection for the period January 1, 2018 through March 31, 2018 on the books for return to customers. PSE&G proposes to return this deferred balance of $27,430,520 ($5,641,142 for electric and $21,789,378 for gas) to customers with interest computed pursuant to the Board's Order, through the Company's newly proposed Tax Adjustment Credit ("TAC"), discussed in more detail below. Mr. Swetz will propose to return these savings to customers in 2018 over a 3 month period.

Q. Please describe what excess deferred taxes are.

A. PSE&G, through the ratemaking process, charges customers current and deferred income tax expense. Current tax expense represents the tax expense expected to be paid to the government for that tax year. Deferred tax expense represents a future tax liability that will be paid when related temporary differences between book and taxable income reverse.

Q. Can you provide an example of this type of temporary difference?

A. An example of such a temporary difference is the difference created by accelerated depreciation. In the case of accelerated depreciation, deductible tax depreciation exceeds book depreciation in the early portion of an asset's life, but then in the later portion of that asset's life, book depreciation exceeds tax depreciation. In the early portion of the asset's life, the high level of the tax benefit of deductible tax depreciation is equivalent to cost-free capital provided by the tax law. In total, the amount of depreciation is the same, just the timing is different. Deferred tax accounting spreads the tax benefit of depreciation over the book life of the property, so that every dollar of book depreciation charged to customers carries a tax benefit. This deferred tax also reduces rate base so that customers receive the benefit of the cost-free capital. While the IRS normalization rules require deferred tax accounting for depreciation-related timing differences, the Board has typically approved deferred tax accounting for other types of timing differences as well.

Q. How does a tax rate change impact a utility's accumulated deferred income taxes?

A. Deferred taxes are calculated using the tax rate in effect at the time the deduction is claimed (historically 35% for federal taxes). However, now that the tax rate has permanently declined to 21%, when those timing differences reverse, the amount of tax owed will be computed at the new lower rate, not the 35% rate. As a result, a portion of PSE&G's existing Accumulated Deferred Income Tax ("ADIT") balance is now in excess of what is needed to offset future tax liabilities; the tax rate change has resulted in excess deferred taxes. These excess deferred taxes fall into two categories – those restricted by the normalization provisions of the Act (sometimes referred to as "protected" ADIT), and those that are not (sometimes referred to as "unprotected" ADIT). The protected excess deferred taxes can be returned to customers, but no more rapidly than permitted under the ARAM. The ARAM provision, which is essentially the same as the rule enacted in the Tax Reform Act of 1986, provides for the reversal of excess ADIT on a vintage and class basis as the related timing differences reverse, using the weighted average tax rate at which deferred taxes were established. By way of contrast, the return of the unprotected excess deferred taxes to customers is unconstrained by the tax law, and can be managed for the mutual benefit of the utility and its customers. Note that any refund of excess deferred taxes previously used to reduce rate base would result in a corresponding increase in rate base and revenue requirement. In Schedule RCK-2 R-2, I show the computation of protected and unprotected excess deferred taxes created by the Act. These amounts represent the Company's best estimates at this time, but are subject to significant change until the 2017 tax return is completed and authoritative guidance is issued.

Q. How do you propose to provide customers the benefit of excess deferred taxes?

A. The Company proposes the benefit of excess deferred taxes be provided to customers using two methodologies:

First, I propose that PSE&G's after tax deferred storm costs and certain other regulatory assets (discussed in the testimony of Mr. Jennings) be offset with unprotected excess deferred taxes. Unprotected excess deferred taxes represent cash already recovered from customers. Rather than returning all of these unprotected amounts to customers through rate credits and then increasing rates to recover storm costs and other regulatory assets, the Company proposes to offset a portion of the excess deferred taxes with after-tax storm costs and other regulatory assets, thereby recovering those costs without increasing current rates. As a result of this offset, the balance of ADIT associated with rate base decreases by the offset. I have reflected the result of this *pro forma* adjustment on Schedule RCK-7 R-2.

Second, the Company proposes to return the balance of excess deferred taxes to customers through either the TAC or through the specific adjustment clause related to that portion of the excess deferred taxes (those associated with the Green Program Recovery Charge). In general, the Company proposes to flow back the protected excess deferred taxes to customers in accordance with the required ARAM method discussed previously. The timing of the refund of the unprotected excess deferred taxes must consider the impact to customer rates as well as the credit metrics of the Company. Based on these considerations, the Company proposes to flow the remaining balance of unprotected excess deferred taxes to customers over a five-year period designed to provide a consistent total flow-back as discussed and developed by Mr. Jennings and Mr. Swetz. The balance of excess deferred taxes to be returned via the TAC, as well as the ARAM amortization for 2018 and 2019, is shown on Schedule RCK-2 R-2.

Q. Do you have a proposed change to your ARAM computation as it relates to Electric Cost of Removal?

A. Yes, there are technical issues with Cost of Removal that were discussed at length in responses to discovery questions S-OCI-PSEG-TAX-0154 through 0156, S-OCI-PSEG-TAX-0093, S-OCI-PSEG-TAX-0040, and S-OCI-PSEG-TAX-0132. The responses, and other discovery responses referenced herein, are attached hereto as Schedule RCK-8 R2. The key issues with respect to Electric Cost of Removal, which are the subject of the Private Letter Ruling request in process for Southern California Edison (included in response to S-OCI-PSEG-TAX-154), include: (1) Whether or not post-1980 cost or removal accruals and deductions are protected temporary differences, and (2) If they are protected, should cost of removal be considered a component of the method life temporary difference or a separate temporary difference for purposes of computing ARAM.

This ruling request, which was not available to us at the time, we were developing our initial position, could have a significant impact on the treatment of excess deferred taxes for Cost of Removal. On the one extreme, Cost of Removal could be found to be unprotected, and thus could be amortized along with other unprotected excess deferred taxes over our proposed 5 years. On the other extreme, COR could be found to protected and a component of the method-life temporary difference. This would cause the ARAM amortization to proceed more slowly than computed in our prior estimate. Given this uncertainty and the draconian penalties associated with a normalization violation, the Company proposes to delay the ARAM amortization associated with Cost of Removal until after the IRS sets forth its position in the Southern California Edison private letter ruling. This will ensure that the Board of Public Utilities' ruling in this case does not violate the normalization rules as it relates to Cost of Removal. Once the IRS issues a ruling, which we expect in 2019, the Company will reconfigure its PowerTax system to comply with the clarified IRS rules and include a catch up adjustment for the allowed amortization of excess deferred taxes in its 2020 TAC filing. Because Cost of Removal related ADIT is a rate base reduction, customers will continue to benefit from the cost of capital savings until such time as that ADIT is returned to customers. In this way, customers will receive the full benefit of excess deferred taxes allowed by IRS rules without risking a normalization violation. The revised amounts of ADIT amortization are reflected on the updated schedule RCK-2 R-2.

Q. Does the Act also include a limitation of the deduction of interest expense?

A. Yes, the Act has a provision limiting the deduction of interest. However, regulated utilities are exempt from this provision. Therefore, there will be no loss of interest deduction for PSE&G and thus no resultant increase in tax.

Q. How does the Act address accelerated and "bonus" depreciation?

A. While the Act provides for 100% depreciation for capital expenditures beginning September 27, 2017, regulated utilities are not eligible for this 100% expensing. The Company believes that beginning on September 27, 2017, only regular Modified Accelerated Cost Recovery System ("MACRS") tax depreciation may be claimed by regulated utilities. There is uncertainty in the Act as to whether some bonus depreciation (either 50% or 100%) may be applied for the period from September 27, 2017 through December 31, 2017. The Company expects clarification of this rule later this year. At this time, PSE&G believes the best interpretation of the Act is that 100% bonus depreciation will not apply to utility property. However, the Company believes the transition rules will permit the application of 50% bonus depreciation to certain capital expenses incurred prior to September 27, 2017 related to projects placed in service after that date. While this conclusion is not free from doubt, the Company has updated Schedules RCK-3 R-2 and RCK-4 R-2 reflecting this interpretation. On August 3, 2018, the Treasury Department released proposed rules dealing with, among other things, the application of the transition rules for bonus depreciation. We are presently analyzing these proposed rules and estimating the impact on our deferred tax and excess deferred tax balances. The actual impact of this or any other authoritative guidance will be adjusted through our proposed TAC.

III. TAX EXPENSE AND ACCUMULATED DEFERRED INCOME TAXES

Q. Have you determined the appropriate income tax expense component of operating income for the filed test period?

A. Yes I have. Based upon 12 months of actual data, I have computed a net total income tax expense of $139.8 million for electric and $77.6 million for gas, comprised of a current tax expense of $71.1 million and ($54.3) million for electric and gas, respectively, and a deferred tax expense of $68.6 million and $131.9 million for electric and gas, respectively. See Schedule RCK-3 R-2. As described in more detail below, I am proposing seven pro forma adjustments that decrease income tax expense by $1.0 million for electric and four pro-forma adjustments that decrease income tax expense by $1.7 million for gas. Therefore, the total income tax expense for the test year is $138.8 million for electric and $75.9 million for gas. The actual and forecast amounts have been updated to reflect: the impact of tax reform on tax expense; the deferred accounting for the tax reform overcollection from January 1 to March 31, 2018; and the April 1st rate reduction implemented to reflect the impact of the Act on rates. The details of these amounts are shown on Schedule RCK-3 R-2, which shows current tax expense and the significant components of deferred tax expense. I provided this tax expense to Mr. Jennings for inclusion in his Schedule SSJ–25 R-2.

Q. Did you prepare a schedule showing the balance of ADIT associated with utility plant?

A. Yes, Schedule RCK–4 R-2 shows a proposed rate base reduction of $1.81 billion for electric and $1.71 billion for gas as of December 31, 2018. As previously discussed, the Company proposes to utilize a portion of the unprotected excess deferred taxes to offset storm costs and certain regulatory assets totaling approximately $141.7 million for electric and $10.2 million for gas. As a result, the adjusted ADIT balance for the period ending December 31, 2018 is approximately $1.67 billion for electric and $1.70 billion for gas. In the Schedule, I have broken utility plant related ADIT down into several categories as follows:

- Accelerated Depreciation and other - includes the federal deferred taxes that either arise or reverse through depreciation deductions (including bonus depreciation) allowed pursuant to sections 167 and 168 of the Internal Revenue Code and certain other plant related deductions such as cost of removal.

- SHARE deductions – include Federal deferred taxes associated with projects that are claimed as deductible repair expenses pursuant to IRC section 162 but are capital assets for financial reporting purposes.

- NJ Corporation Business Tax – includes all deferred taxes provided for the NJ Corporation Business Tax.

- Protected Excess Deferred Taxes

- Unprotected Excess Deferred Taxes

Mr. Jennings has reflected these deferred taxes as a rate base reduction in Schedule SSJ–03 R-2.

Q. Are there any adjustments that should be made to income taxes?

A. Yes. The flow through of the federal tax benefit associated with the tax deduction of the Asset Depreciation Range ("ADR") Repair Allowance should be eliminated and replaced with a flow through of the federal tax benefit for the new SHARE deduction via a new TAC discussed below (Adjustment 1). In addition, the Company is proposing several other adjustments to income tax expense including: an Investment Tax Credit ("ITC") reclass, an elimination of the deduction permitted under Section 199 of the Internal Revenue code (as discussed in the response to S-PSEG-OCI-TAX-0142), removal of the tax on the deferred gain on the sale of generation assets (as discussed in the response to S-PSEG-OCI-TAX-0080), removal of a one-time return to accrual adjustment (as discussed in the response to S-PSEG-OCI-TAX-0144), and an operating versus non-operating income adjustment as described in more detail below and the amounts shown on RCK-3 R-2 (as discussed in the response to S-PSEG-OCI-TAX-0179, 0129 and 0139). These responses are all included in Schedule RCK-8.

Q. What is the ITC reclass adjustment to income tax?

A. There is an equal and offsetting $4.7 million adjustment to income taxes between electric and gas. This adjustment relates to a correction of the unamortized ITC balance that resides on the balance sheet between the divisions. As this is related to a balance sheet reclass, the income statement impact should be removed.

Q. What is the adjustment to eliminate the Section 199 deduction?

A. The section 199 deduction is the percentage deduction allowed for a percentage of income generated from production activities, in this case, the generation of electricity using solar energy. This deduction is related to the Company's solar program and is not reflected in an adjustment clause separate from base rates. This deduction was repealed by the Act effective in 2018. This tax benefit should be removed from operating income as that benefit will not be available for years when new rates will be in effect.

Q. What is the removal of the tax on the deferred gain on the sale of generation assets?

A. The tax implications of the deferred gain on sale of generating assets relates to the sale of PSE&G's generating assets to PSEG Power. Tax on this gain must be excluded from ratemaking in order to avoid violating the normalization rules. Inadvertently, one small portion of the tax on this gain was included in operating tax expense. This adjustment removes both the current and deferred impact of that error. Because the current and deferred impact exactly offset, there is no change to overall tax expense. The net impact is zero.

Q. How do you address removal of the one-time return to accrual adjustment?

A. This is a 2016 return to accrual amount for the test period that represents an entry that was inadvertently recorded in the electric distribution division instead of PSE&G's Solar Program. For rate case purposes, this amount should be removed from electric distribution tax expense. This adjustment removes that entry.

Q. What is the adjustment for operating versus non-operating tax expense?

A. It was discovered that during the test period the electric and gas operating pre-tax income used in computing tax expense was out of sync with pre-tax operating income reported for financial statement purposes. Accordingly, a full test year update was made to pre-tax income used in computing tax expense. This adjustment comprises two pieces: (1) to meet the closing calendar, tax generally is required to use a preliminary operating income amount (see response to S-OCI-PSEG-TAX-0179, included in Schedule RCK-8), and (2) in December 2017 the electric operating pre-tax income used in computing tax expense included non-operating income related to the Company's renewables programs (see responses to S-OCI-PSEG-TAX-0129 and 0139, also included in Schedule RCK-8).

Q. What is the ADR Repair Allowance?

A. The ADR Repair Allowance is a deduction set out in Treasury Regulation 1.167-11(d)(2). It provides that certain qualifying capital additions to property may be currently deductible as an expense up to a defined cap. It only applies to additions to or replacements of older units of property (placed in service prior to 1981). Because it only applies to these older vintages of property and is capped, the size of the deduction is limited.

Q. Why do you propose eliminating the ADR Repair Allowance from operating income?

A. In short, because the Company no longer deducts the ADR Repair Allowance for electric distribution property.

Q. Why did the Company stop deducting the ADR Repair Allowance?

A. On September 12, 2011, the IRS released Revenue Procedure 2011-43 (which was later modified in Revenue Procedure 2014-16), detailing a safe harbor method for determining repair deductions for electric utilities. These rules apply to all vintages of property and permit a significantly larger repair deduction than was permitted under the ADR Repair Allowance rules. Section 5(7) of that Revenue Procedure provides that taxpayers that wished to adopt the safe harbor method set out in the Revenue Procedure were precluded from electing the ADR Repair Allowance. While the Company began claiming enhanced repair deductions in 2010 for both electric and gas distribution, the provision precluding the repair allowance deduction for electric distribution had to be satisfied beginning with the 2013 tax year. Accordingly, because the repair deduction under the new safe harbor provision was substantially larger than under the old ADR Repair Allowance, effective in 2013 PSE&G adopted the SHARE revenue procedure and did not elect an ADR Repair Allowance on its tax return for that year or any year since for electric distribution property.

Q. How do you propose that SHARE deduction affect ratemaking?

A. Because the Board required PSE&G to flow through the ADR Repair Allowance deduction for ratemaking purposes, and because that ADR Repair Allowance deduction has been replaced by the larger SHARE deduction, the Company now proposes to flow back to customers the SHARE deduction in place of the ADR repair allowance deduction.

Q. What is deferred tax accounting and how does it differ from flow through accounting?

A. Generally Accepted Accounting Principles ("GAAP)," now codified as ASC 740, require comprehensive inter-period tax allocation for all temporary differences between book and tax accounting. Simply stated, a temporary difference is an item of income or expense, for which the difference in basis or timing of recognition in income differs for tax purposes and financial reporting purposes. When a temporary difference is reflected in the computation of taxable income in a different period than it is for financial reporting purposes, there is an impact on the timing of taxation, and GAAP requires that a deferred tax expense or benefit be recorded on the income statement to reflect the future reversal of that temporary difference. A deferred tax expense results in an increase in ADIT liabilities on the balance sheet, and the liability reverses as the Company repays the temporary benefit to the government in the form of higher tax payments in the future. This is what I refer to as deferred tax accounting.

Q. Has the Board ever decided not to use deferred tax accounting?

A. In some cases, the Board has chosen not to recognize these deferred tax impacts for ratemaking purposes, allowing the impact in the current period tax return to flow through to the income statement and be recognized currently for ratemaking purposes. This choice to not allow deferred taxes in the computation of utility tax expense for ratemaking is what I refer to as "flow through accounting."

Q. Can you describe flow through accounting?

A. To say it simply, flow through accounting puts the utility on a tax return basis (cash basis) for tax recovery in the ratemaking process. Tax expense or benefit of the particular item will flow to customers in the year in which the taxes are reflected in the tax return. Deferred tax accounting, in contrast, matches the tax impact of an item of expense or income with the recovery of that item from customers.

Q. Please provide an example of the difference between flow through and deferred tax accounting.

A. A classic example is the Allowance for Doubtful Accounts (also known as uncollectible expense). For financial reporting purposes, an expense is accrued each year related to the accounts receivable from customers estimating the amount of those receivables that will ultimately be uncollectible. For tax purposes, this reserve is not deductible until specific accounts receivable actually are declared uncollectible and abandoned. This typically happens in a year after the book reserve was accrued.

For example, assume in year 1 that a $1,000 expense is accrued on the books related to estimated uncollectible accounts. For tax purposes, this expense is not deductible in year 1, so an adjustment is made in the tax return to disallow that book deduction. Accordingly, there will be no current tax benefit for that $1,000 reserve in Year 1. In year 2, assume the actual account is written off and the $1,000 then becomes deductible in the tax return in year 2 resulting in a $210 tax benefit in year 2 ($1,000 deduction times the 21% Federal tax rate).

If flow through accounting is employed, the full $1,000 bad debt reserve would be charged to utility customers in year 1 and the $210 tax benefit would be passed to customers in year 2 because that is the year in which the FIT deduction would be recognized. If deferred tax accounting is employed, a $210 deferred tax benefit would be recorded in year 1, and the amount charged to customers in year 1 would be $790 ($1,000 less the $210 deferred tax benefit). There would be no customer impact in Year 2.

Q. Would the flow through of the SHARE deduction jeopardize the Company's ability to claim that or any other deductions?

A. No, it would not. Unlike accelerated depreciation, for example, the SHARE deduction is not within the scope of the IRS normalization rules, so deferred tax accounting is not an IRS requirement. Moreover, flowing this tax benefit through to customers is consistent with PSE&G's past Board Order in Docket Number ER85121163. If, as that Order establishes, it was permissible to flow through one type of repair deduction, it follows that the SHARE deduction could also be flowed through to customers.

Q. How much larger is the SHARE than the ADR Repair Allowance?

A. For the period 2010 through 2015, the total ADR Repair Allowance deduction was approximately $300 million versus the total SHARE deduction of approximately $1.7 billion, which includes a one-time change in accounting method adjustment. Clearly the larger deduction is in the Company's and customers' best interests, so the Company changed to the SHARE.

Q. Is either the flow-through or deferred tax accounting method required?

A. With two exceptions, neither method is required in setting rates. The first exception is for ratemaking purposes, deferred tax accounting is required when the normalization rules of the Internal Revenue Code ("IRC") apply. Under those rules, the deduction for accelerated depreciation will be forfeited if the benefit is flowed through to customers instead of being normalized. These rules however, specifically apply only to deductions associated with accelerated depreciation claimed pursuant to IRC sections 167 and 168. The normalization rules do not apply to deductions claimed under any other section of the Code. The SHARE deduction is not claimed under either of those IRC sections, so normalization is not required for this repair deduction for federal income tax purposes.

The second exception is that *N.J.S.A.* 48:2-21.34 requires deferred tax accounting in setting utility rates for all temporary differences used in computing New Jersey ("NJ") State income tax. So no ADIT computed at the NJ rate may be flowed through. Therefore, normalization would be required for the NJ State income tax portion of the SHARE deduction.

Q. Is one method to be preferred over the other?

A. Arguments can be made for each method of ratemaking, and the choice should be determined based upon company specific facts and circumstances. On the one hand, deferred tax accounting is consistent with GAAP and matches an expense with its related tax benefit, ensuring that a customer who pays for a particular expense also receives the related tax benefit. Further, for utilities that are in need of cash flow, deferred tax accounting can provide cash by allowing the utility to retain the cash benefit of accelerated deductions for a longer period of time (resulting, of course, in higher rates in the near term).

On the other hand, deferred taxes by their nature are not paid to the government until a future period. Where a company's cash position is relatively sound, it may be more appropriate to not collect deferred taxes from customers until they are actually due and payable to the taxing authority. Both methods are widely employed across the country and have been employed by PSE&G.

Q. When PSE&G initially claimed the SHARE deduction, did the Company provide deferred taxes on that deduction and, if so, why?

A. Generally, yes. The Company did so because GAAP requires the deferred tax method of accounting for *temporary* differences. Only a specific order of the Board can cause a tax adjustment to be flowed through in the financial statements. Consequently, PSE&G reviewed prior Board orders and concluded they applied only to an amount of repair deduction attributable to the ADR Repair Allowance, not to the larger SHARE deduction. Nevertheless, it was apparent the SHARE deduction and the ADR repair allowance are similar in nature as they both relate to deducting similar costs as repair costs for tax purposes. In fact, the ADR repair allowance is a subset of the larger SHARE deduction. Accordingly, PSE&G continued to flow through a portion of the SHARE deduction that was equal to the ADR repair allowance deduction. Deferred taxes were recorded for the balance of the SHARE deduction.

Q. How does the Company propose to implement the flow through adjustment?

A. The Company proposes to implement this adjustment in two separate pieces:

1. A *pro forma* adjustment to test period tax expense;

2. The creation of a TAC to flow through the current SHARE benefit and to amortize the remaining balance of SHARE related ADIT back to customers.

I will describe each of these in more detail.

1. <u>*Pro forma* adjustment to test period tax expense.</u>

Schedule RCK-5 R-2 – Adjustment 1, shows the computation of the *pro forma* adjustment to eliminate the flow through tax benefit of the ADR repair allowance. While this adjustment will eliminate the flow-through benefit of the ADR repair allowance from base rates, the entire SHARE deduction, which includes the ADR repair allowance currently being flowed through to customers for ratemaking purposes, will be flowed through to customers through the proposed TAC. This adjustment effectively removes the tax benefit of the ADR Repair allowance deduction net of the related book depreciation for the test period. I have not modified test period tax expense for the flow through of the SHARE deduction as that will be included in the proposed TAC discussed below. I have adjusted the test period tax expense in Schedule RCK-3 R-2 by the adjustment computed in RCK-5 R-2, Adjustment 1.

2. <u>Flow through of the current SHARE deduction, amortization and flow through of the remaining ADIT related to the SHARE deduction, and truing up amounts in the future through a tax adjustment charge or credit.</u>

The Company proposes that the flow through of the estimated current period SHARE tax benefit as well as the SHARE related ADIT, net of the resultant change in return-related revenue requirement, be accomplished through the TAC. The SHARE related ADIT will be the balance at the time amortization of the SHARE-related ADIT commences in the TAC. While the Company proposes the flow through of the current period SHARE benefit commence immediately when new rates go into effect, the Company proposes to delay returning the balance of SHARE-related ADIT until after the balance of unprotected excess deferred taxes has been returned to customers.

Q. Can you describe your proposed TAC in more detail?

A. I propose the creation of a TAC, to be adjusted annually. The TAC is essentially a tax adjustment clause that will be used to make significant tax adjustments annually outside of a full base rate proceeding. As discussed above, the Company plans on using the TAC for the following purposes:

a. This would be the mechanism to return to customers the tax savings collected from January 1, 2018 through March 31, 2018 with interest in 2018 over a three month period.

b. This would be the mechanism to return excess deferred taxes created by the Act to customers. Protected deferred taxes would be returned using the ARAM and unprotected deferred taxes would be returned over an approximately five year period. The adjustment would be computed net of the return impact due to the change in ADIT, as described in more detail in the testimony of Mr. Swetz.

c. This would be the mechanism to flow thru to customers the current period tax benefit associated with the SHARE deduction, as well as return the unamortized balance of SHARE-related ADIT in a future period. This adjustment would be computed net of the return impact due to the change in ADIT, as described in more detail in the testimony of Mr. Swetz. The amortization of the SHARE related ADIT will commence after the unprotected excess deferred taxes have been returned to customers. The actual computation of the initial revenue credit and the operational details of the TAC are detailed in the testimony of Mr. Swetz.

d. The TAC would also serve as a mechanism to more accurately reflect in rates on an annual basis the current period SHARE deduction benefit each year and true it up to actuals in the following year. The repair deduction has the potential to vary significantly from year to year based on the mix of capital projects undertaken. Swings in the range of tens of millions of dollars in SHARE-related benefits year to year are possible. To ensure that customers get the full benefit of the SHARE deduction, the Company proposes the TAC to ensure rates are accurate and are trued up annually for actual repair deductions. The mechanics of the TAC are discussed in Mr. Swetz's testimony.

e. The TAC would further provide a mechanism that will permit the recovery of IRS audit adjustments and changes in the tax law, if any. While the IRS has not yet challenged the Company's SHARE deductions, tax deductions of this magnitude are routinely scrutinized. Given the size of these deductions and the IRS's policy of auditing multiple years at a time, a final disallowance could be material. Because the tax benefit of any deductions will have already been passed to customers, any IRS disallowance and interest thereon would need to be recovered from customers. The TAC will provide the mechanism to ensure timely recovery.

Q. What are other benefits associated with the TAC that you are proposing?

A. Utilizing the TAC to adjust the credit annually has several benefits. First, it allows for an uneven method of amortization, which could not be done in a traditional base rate amortization without an annual base rate case. It also permits flow through of the annual best estimate of the current period SHARE benefit as well as the true-up to actual SHARE deductions to ensure customers receive the full flow through benefit. Finally, it provides a mechanism to stop the amortization of historical ADIT once the excess deferred taxes and SHARE related ADIT are fully returned to customers, in order to avoid possible IRS normalization violations. If the Company were to over-amortize the unprotected excess deferred balance or the SHARE deduction related ADIT balance, the excess amortization arguably would come from the depreciation related ADIT, which is protected by the normalization rules. Reversing that deferred tax would result in a normalization violation and the possibility of significant penalties. Use of the TAC avoids that risk entirely.

Q. Is there any other benefit associated with the TAC you are advocating?

A. Yes. The TAC is a mechanism the Company suggests using to address other major tax changes, now (i.e., the changes occasioned by the Act described above) or in the future.

Q. Why do you propose to flow through only the federal deferred tax related to the SHARE deduction?

A. As noted above, *N.J.S.A.* 48:2-21.34 requires deferred tax accounting in setting utility rates for all temporary differences in computing New Jersey State income tax. Accordingly, as the New Jersey statute does not allow for flow through, the Company is not proposing the flow through of the state deferred taxes.

IV. <u>CONSOLIDATED TAX ADJUSTMENT</u>

Q. What is a Consolidated Tax Adjustment?

A. In the simplest terms, a Consolidated Tax Adjustment ("CTA") is a ratemaking adjustment designed to pass some or all of the benefit of tax savings generated by nonregulated subsidiaries of a consolidated return filing group to the regulated affiliate.

Q. Has the Board ever issued an order mandating a CTA in a previous PSE&G rate case?

A. No. Although Rate Counsel and its predecessors have proposed a CTA in many of PSE&G's rate proceedings, all of those cases were settled without specific resolution of the CTA.

Q. Do you believe that the imposition of a CTA is appropriate?

A. No I do not. I and others representing PSE&G have testified several times in New Jersey about the flaws of the CTA adjustment. I continue to believe the imposition of a CTA is an inappropriate regulatory adjustment.

Q. Has the Board purported to revise its policy regarding CTAs since PSE&G's last rate case?

A. Yes it has. On January 23, 2014 the Board issued an order opening Docket EO12121072, a generic proceeding to review the applicability and computation of the CTA. On November 22, 2014 the Board issued an order ("November 22 Order") in that docket setting out key computational requirements with respect to the CTA. Those requirements represented a significant change from computations that had been approved by the Board in the past. The order in this generic proceeding was ultimately reversed on appeal. I am advised by counsel that that reversal was on "procedural grounds"; the court provided no opinion regarding the computational requirements the Board has recently set out. However, the Board has issued a decision in a litigated proceeding that is consistent with its November 22 Order in *I/M/O the Verified Petition Of Jersey Central Power & Light Company For Review and Approval Of Increases In And Other Adjustments To Its Rates And Other Charges For Electric Service*, BPU Docket No. ER12111052, Order Adopting Initial Decision With Modifications and Clarifications (March 26, 2013)("JCP&L Order"), at page 73. It is my understanding that this decision was not affected by the reversal of the November 22 Order. In addition, at its December 19, 2017 agenda meeting, the Board adopted a proposed formal rule codifying use of this method going forward.

Q. Please briefly describe these computational requirements and how they differ from past computations?

A. The computational requirements are:

1. The calculation period for the CTA shall include a look back period of five calendar years, including any complete year that is included in the test year. The Board's previous orders for other companies had approved a lookback period beginning in 1991 continuing through the test period.

2. The calculated tax adjustment based on the review period shall be allocated so that the revenue requirement of the company is reduced by 25% of the adjustment. In the past, the Board has approved revenue requirement reduction of 100% of the computed adjustment.

3. Transmission assets of the Electric Distribution Companies would not be included in the calculation of the CTA. In past orders, the Board did not make this distinction.

Q. Have you included a computation of the CTA that is consistent with the JCP&L Order?

A. Yes I have. In Confidential Schedules RCK–6A R-2 and 6B R-2, I have provided data dating back to 1991 consistent with data provided in the CTA generic proceeding, updated for settled IRS audits. Confidential Schedule RCK–6A R-2 presents the computation of the CTA and Confidential Schedule RCK–6B R-2 presents the computation separating transmission taxable income from electric taxable income. I then computed a CTA using this data in accordance with the JCP&L Order. The resulting CTA is a reduction of rate base equal to $0.5 million for electric and $0.2 million for gas. Mr. Jennings has included this amount in rate base as shown in Schedule SSJ–03 R-2.

Q. Notwithstanding the Board's recent decisions concerning the CTA, do you believe this is an appropriate adjustment to make?

A. No I do not. I have always believed and continue to believe that the CTA is an inappropriate ratemaking adjustment and the practice should be eliminated, as it has been in most states. Nevertheless, the Company has computed and provided an adjustment consistent with the JCP&L Order.

Q. Does this conclude your testimony at this time?

A. Yes, it does.

QUALIFICATIONS OF
ROBERT C. KRUEGER, JR.

Educational Background

In 1982 I graduated from Bucknell University with a Bachelor of Science n Business Administration – Accounting Degree. In 1983, I earned the degree of Master of Business Administration from Lehigh University. I have been a licensed Certified Public Accountant in the State of New Jersey since 1985.

Work Experience

Between 1983 and 1988, I was employed by the accounting firm of Deloitte, Haskins, and Sells (DH&S) and performed general auditing and tax accounting. I commenced employment with Public Service Electric and Gas Company (PSE&G) in 1988 as a Principal Tax Account. 1992, I was promoted to Director – Tax Services, where I was responsible for tax compliance , as well as accounting and planning activities. In 1999, I was promoted to Director – Financial Planning and Analysis, responsible for business forecasting and budgeting. In 2000, I assumed the responsibility for analysis of accounting and tax strategies for PSE&G and Public Service Enterprise Group Incorporated. In 2006, I was promoted to Vice-President and Assistant Controller – Tax and have been responsible for all tax matters of the Enterprise Group. Effective January 1, 2018, I was assigned the role of Vice President – Special Projects.

I am a member of the American Institute of Certified Public Accountants and the New Jersey State Society of Certified Public Accountants.

I have testified before the New Jersey Board of Public Utilities (NJBPU) during the PSE&G Energy Master Plan Phase II proceeding, whereby the NJBPU conducted investigations into the future structure of the electric power industry. I have also testified in the 2001 PSE&G Gas Base Rate Case proceeding. In both of these rate proceedings, I served as the PSE&G accounting witness, responsible for all accounting and tax-related issues. I also provided rebuttal testimony in PSE&G's 2009 base rate case.

In 2002, I was appointed by the Governor of the State of New Jersey, James E. McGreevey, to the New Jersey Corporate Business Tax Study Commission. I served on this Commission until June of 2004, when the Commission issued its final report.

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
Computation of Excess Accumulated Deferred Income Tax at 12/31/17
12+0 Update

Electric Distribution

Temporary Difference	TYPE	Regulated Excess Deferred Tax	At ADIT level	Related to Specific Adjustment Clauses	Excess Deferreds used to offset Regulatory Assets	Excess Deferreds to Flow through the TAC	Ratebase Related Excess Deferred	% ratebase related
Depreciation	protected	(429,110,188)						
Safe Harbor Accellerated Repair Expense (S.H.A.R.E)	unprotected	(81,816,130)						
Other Plant Basis Differences	unprotected	(128,502,198)						
Plant Related State Tax	unprotected	40,065,322						
Pension	unprotected	(53,655,754)						
OPEB	unprotected	74,728,578						
Regulatory Assets (excluding pension & Opeb and netted against related nondeductible liabilities)	unprotected	(63,901,924)						
State Tax excluding Fin 48 and Plant Related	unprotected	(15,516,898)						
Pending Audit Adjustments at new rate	unprotected	4,582,171						
Pending Audit Adjustments (retained at 35%)	no excess	-						
Other - excluding Fin 48	unprotected	(6,706,834)						
Total before Gross -up		(659,833,855)						
Gross up to Revenue level		(258,004,308)						
Total Refundable		(917,838,163)	Less: Adjustment (Tax-170)	Initial Submission				
Service Company Excess Deferred taxes billed to PSE&G	unprotected	5,388,777	(400,921)	5,789,698				
Net Regulatory Liability		(912,449,386)						
		At revenue level						
Total Protected - Electric		(596,898,300)	(429,110,188)	43,793,104		(385,317,084)	(429,110,188)	
Less ARAM Amortization from 1/1/18 thru 9/30/18		6,748,546	4,851,530			4,851,530	4,851,530	
Remaining Protected - Electric		(590,149,754)	(424,258,658)	43,793,104	-	(380,465,554)	(424,258,658)	100%
Total Unprotected - Electric		(315,551,086)	(226,849,676)	5,436,483	187,502,448	(33,910,745)	(170,253,006)	
Less ARAM Amortization from 1/1/18 thru 9/30/18		(6,748,546)	(4,851,530)			(4,851,530)	(4,851,530)	
Remaining Unprotected - Electric		(322,299,632)	(231,701,205)	5,436,483	187,502,448	(38,762,275)	(175,104,536)	76%
Total		(912,449,386)	(655,959,863)	49,229,587	187,502,448	(419,227,828)	(599,363,194)	91%

Gas Distribution

Temporary Difference		Regulated Excess Deferred Tax	At ADIT level	Related to Specific Adjustment Clauses	Excess Deferreds used to offset Regulatory Assets	Excess Deferreds to Flow through the TAC	Ratebase Related Excess Deferred	% ratebase related
Depreciation	protected	(331,327,484)						
Safe Harbor Accellerated Repair Expense (S.H.A.R.E)	unprotected	(164,103,927)						
Other Plant Basis Difference	unprotected	(82,319,165)						
Plant Related State Tax	unprotected	37,202,820						
Pension	unprotected	(41,174,033)						
OPEB	unprotected	4,406,461						
Regulatory Assets (excluding pension & Opeb and netted against related nondeductible liabilities)	unprotected	(35,747,669)						
State Tax excluding Fin 48 and Plant Related	unprotected	6,108,555						
Pending Audit Adjustments at new rate	unprotected	1,195,764						
Pending Audit Adjustments (retained at 35%)	no excess	-						
Other	unprotected	1,406,316						
Total before Gross -up		(604,352,361)						
Gross up to Revenue level		(236,310,264)						
Total Refundable		(840,662,625)	Less: Adjustment (Tax-170)	Initial Submission				
Service Company Excess Deferred taxes billed to PSE&G	unprotected	4,963,346	(369,270)	5,332,616				
Net Regulatory Liability		(835,699,279)						
		At revenue level						
Total Protected - GAS		(460,881,185)	(331,327,484)			(331,327,484)	(331,327,484)	
Less ARAM Amortization from 1/1/18 thru 9/30/18		6,550,327	4,709,030			4,709,030	4,709,030	
Remaining Protected - GAS		(454,330,857)	(326,618,453)	-	-	(326,618,453)	(326,618,453)	100%
Total Unprotected - GAS		(374,818,095)	(269,456,728)	3,543,118	13,070,146	(252,843,464)	(209,220,273)	
Less ARAM Amortization from 1/1/18 thru 9/30/18		(6,550,327)	(4,709,030)			(4,709,030)	(4,709,030)	
Remaining Unprotected - GAS		(381,368,422)	(274,165,759)	3,543,118	13,070,146	(257,552,494)	(213,929,303)	78%
Total		(835,699,279)	(600,784,212)	3,543,118	13,070,146	(584,170,948)	(540,547,756)	90%

At revenue level	At ADIT level
(1,044,480,611)	(750,877,111)
(703,668,054)	(505,866,964)
(1,748,148,665)	(1,256,744,075)

Note: These amounts represent our best estimates at this time, but are subject to significant change with the filing of the 2017 tax return and any audits of prior periods, changes in law or interpretation of law.
Any required adjustments will be reflected in our proposed Tax Adjustment Credit (TAC).

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
Computation of Excess Accumulated Deferred Income Tax at 12/31/17
12+0 Update

Electric Distribution

Temporary Difference	TYPE	Normalized Temporary Difference	Reclasses	Normalized Temporary Difference	Regulated Federal ADIT @ 35.00%	Regulated Federal ADIT 21.00%	Regulated Excess Deferred Tax
Depreciation	protected	(3,065,072,770)		(3,065,072,770)	(1,072,775,470)	(643,665,282)	(429,110,188)
Safe Harbor Accellerated Repair Expense (S.H.A.R.E)	unprotected	(584,400,927)		(584,400,927)	(204,540,324)	(122,724,195)	(81,816,130)
Other Plant Basis Differences	unprotected	(917,872,846)		(917,872,846)	(321,255,496)	(192,753,298)	(128,502,198)
Plant Related State Tax	unprotected	150,689,301	135,491,572	286,180,873	100,163,305	60,097,983	40,065,322
Pension	unprotected	(383,255,388)		(383,255,388)	(134,139,386)	(80,483,632)	(53,655,754)
OPEB	unprotected	533,775,554		533,775,554	186,821,444	112,092,866	74,728,578
Regulatory Assets (excluding pension & Opeb and netted against related nondeductible liabilities)	unprotected	(456,442,312)		(456,442,312)	(159,754,809)	(95,852,886)	(63,901,924)
State Tax excluding Fin 48 and Plant Related	unprotected	24,656,583	(135,491,572)	(110,834,988)	(38,792,246)	(23,275,348)	(15,516,898)
Pending Audit Adjustments at new rate	unprotected	32,729,794		32,729,794	11,455,428	6,873,257	4,582,171
Pending Audit Adjustments (retained at 35%)	no excess	(32,729,794)		(32,729,794)	(11,455,428)	(11,455,428)	-
Other - excluding Fin 48	unprotected	(47,905,956)		(47,905,956)	(16,767,085)	(10,060,251)	(6,706,834)
Total before Gross -up		(4,745,828,760)	-	(4,745,828,760)	(1,661,040,066)	(1,001,206,211)	(659,833,855)

Gas Distribution

Temporary Difference	TYPE	Normalized Temporary Difference	Reclasses	Normalized Temporary Difference	Regulated Federal ADIT @ 35.00%	Regulated Federal ADIT 21.00%	Regulated Excess Deferred Tax
Depreciation	protected	(2,366,624,883)		(2,366,624,883)	(828,318,709)	(496,991,225)	(331,327,484)
Safe Harbor Accellerated Repair Expense (S.H.A.R.E)	unprotected	(1,172,170,909)		(1,172,170,909)	(410,259,818)	(246,155,891)	(164,103,927)
Other Plant Basis Difference	unprotected	(587,994,038)		(587,994,038)	(205,797,913)	(123,478,748)	(82,319,165)
Plant Related State Tax	unprotected	265,734,429		265,734,429	93,007,050	55,804,230	37,202,820
Pension	unprotected	(294,100,233)		(294,100,233)	(102,935,082)	(61,761,049)	(41,174,033)
OPEB	unprotected	31,474,718		31,474,718	11,016,151	6,609,691	4,406,461
Regulatory Assets (excluding pension & Opeb and netted against related nondeductible liabilities)	unprotected	(255,340,494)		(255,340,494)	(89,369,173)	(53,621,504)	(35,747,669)
State Tax excluding Fin 48 and Plant Related	unprotected	43,632,538		43,632,538	15,271,388	9,162,833	6,108,555
Pending Audit Adjustments at new rate	unprotected	8,541,174		8,541,174	2,989,411	1,793,647	1,195,764
Pending Audit Adjustments (retained at 35%)	no excess	(8,541,174)		(8,541,174)	(2,989,411)	(2,989,411)	-
Other	unprotected	10,045,117		10,045,117	3,515,791	2,109,475	1,406,316
Total before Gross -up		(4,325,343,754)	-	(4,325,343,754)	(1,513,870,314)	(909,517,953)	(604,352,361)

Forecasted ARAM Amortization

	1/1/18 - 9/30/18	10/1/18 - 12/31/19
Electric	7,624,182	13,200,598
(less Electric ARAM for Cost of Removal held pending IRS ruling)	(2,772,652)	(4,611,346)
Net Electric	4,851,530	8,589,252
Gas	4,709,030	8,624,011
Total	9,560,560	17,213,262

Note: These amounts represent our best estimates at this time, but are subject to significant change with the filing of the 2017 tax return and any audits of prior periods, changes in law or interpretation of law.
Any required adjustments will be reflected in our proposed Tax Adjustment Credit (TAC).

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
CURRENT AND DEFERRED INCOME TAXES
12+0 Update

		($000)		
		Test year ended 6/30/18		
Line		Electric	Gas	Total
1	***Current***			
2	Federal	$ 79,472	$ (35,165)	$ 44,306
3	State	$ (8,326)	$ (19,117)	$ (27,443)
4	***Total Current***	$ 71,146	$ (54,282)	$ 16,864
5	***Deferred***			
6	Depreciation and Other - federal	$ 26,584	$ 59,416	86,000
7	Repair - federal	$ 6,988	$ 65,917	72,905
8	State - plant related	$ 24,121	$ 35,591	59,712
9	Loss on Reacquired Debt	$ (585)	$ (181)	(765)
10	Clause - RAC (Environmental Clean Up)	$ 7,585	$ (728)	6,857
11	Clause - Societal Benefits Clause (AAP)	$ 4,886	$ (1,503)	3,382
12	Clause - Deferred Fuel	$ 2,416	$ (5,013)	(2,597)
13	Contributions in Aid of Construction	$ (9,867)	$ (1,265)	(11,132)
14	Pension - Tax Deduction	$ 3,357	$ 2,277	5,634
15	OPEB - Tax Deduction	$ 10,081	$ (5,920)	4,161
16	Other	$ (1,475)	$ (6,446)	(7,922)
17	Excess Deferred Tax - Cost Of Removal	$ -	$ (14,373)	(14,373)
18	Total Deferred	$ 74,090	$ 127,771	$ 201,862
19	Investment Tax Credit Amortized	$ (5,463)	$ 4,148	(1,315)
20	Net Income Taxes	$ 139,773	$ 77,637	$ 217,411
	Proforma Adjustments:			
21	Remove ADR Repair Allowance - RCK-5 R-2 Adjustment 1	4,966	2,098	7,065
22	ITC Reclass - RCK 5 R-2 Adjustment 3	4,725	(4,725)	-
23	Operating vs Non-Op Income- RCK 5 R-2 Adjustment 4	(8,432)	-	(8,432)
24	Power Spin Off Def Gain on InterCo Trans - RCK-5 R-2 Adjustment 5	0	0	0
25	Elimination of IRC 199 Manufacturer's Deduction - RCK-5 R-2 Adjustment 6	794	-	794
26	Remove Solar 2016 Return to Accural - RCK-5 R-2 Adjustment 7	(3,099)	-	(3,099)
27	To Adjust For Correct Operating Income - RCK-5 R-2 Adjustment 8	66	901	967
28	Adjusted income taxes	138,793	75,911	214,704

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
ACCUMULATED DEFERRED TAXES - ELECTRIC
($000)
12+0 Update

	Estimated Balance 6/30/18	Reclass Of GPRC Excess ADIT (See Tax-0116)	Revised Estimated Balance 6/30/18	Activity	Revised Estimated Balance 12/31/18
Depreciation & Other	$ (748,339)	$ (43,793)	$ (792,132)	$ (9,611)	$ (801,743)
Repair Deduction	$ (126,608)		$ (126,608)	$ (3,884)	$ (130,493)
NJ Corporate Business Tax	$ (306,419)		$ (306,419)	$ (16,297)	$ (322,717)
Protected Excess Deferred Tax	$ (432,762)	$ 43,793	$ (388,969)	$ -	$ (388,969)
Unprotected Excess Deferred tax	$ (166,601)		$ (166,601)	$ -	$ (166,601)
Total Electric Accumulated Deferred Taxes	$ (1,780,730)	$ -	$ (1,780,730)	$ (29,792)	$ (1,810,522)
Proforma Adjustments:					
Storm Cost Offset - Excess Deferred Tax	$ 141,702		$ 141,702	$ -	$ 141,702
Adjusted Electric Accumulated Deferred Taxes	$ (1,639,028)	$ -	$ (1,639,028)	$ (29,792)	$ (1,668,820)

ACCUMULATED DEFERRED TAXES - GAS
($000)

	Estimated Balance 6/30/18	Reclass Of GPRC Excess ADIT (See Tax-0116)	Revised Estimated Balance 6/30/18	Activity	Estimated Balance 12/31/18
Depreciation & Other	$ (574,060)		$ (574,060)	$ (11,125)	$ (585,185)
Repair Deduction	$ (266,678)		$ (266,678)	$ (20,523)	$ (287,201)
NJ Corporate Business Tax	$ (281,183)		$ (281,183)	$ (15,449)	$ (296,633)
Protected Excess Deferred Tax	$ (329,310)		$ (329,310)	$ -	$ (329,310)
Unprotected Excess Deferred tax	$ (211,237)		$ (211,237)	$ -	$ (211,237)
Total Gas Accumulated Deferred Taxes	$ (1,662,470)	$ -	$ (1,662,470)	$ (47,097)	$ (1,709,567)
Proforma Adjustments:					
Storm Cost Offset - Excess Deferred Tax	$ 10,199		$ 10,199	$ -	$ 10,199
Adjusted Electric Accumulated Deferred Taxes	$ (1,652,271)	$ -	$ (1,652,271)	$ (47,097)	$ (1,699,368)

Note: The amounts above include all plant related excess deferred taxes. The rate base reduction for excess deferred taxes will not be reduced until excess deferred taxes are returned to customers.

Public Service Electric and Gas Company

Adjustments related to the conversion from ADR Repair Allowance to Safe Harbor Repairs and to Test Year Income Tax Expense

($000's)

12+0 Update

Adjustment 1

	Electric			Gas			Total		
Proforma Adjustment to Test Period Tax Expense / **Remove ADR Repair Allowance flow Through**	July - December	January - June	Total Test Period	July - December	January - June	Total	July - December	January - June	Total
ADR Repair Allowance deduction included in the test period	(17,534)	(16,500)	(34,034)	(4,991)	(5,000)	(9,991)	(22,526)	(21,500)	(44,026)
Book Depreciation associated with ADR Repair Allowance property	8,465	7,966	16,431	1,247	1,249	2,496	9,712	9,215	18,927
Net flow through deduction included in test period	(9,069)	(8,534)	(17,603)	(3,745)	(3,751)	(7,496)	(12,814)	(12,285)	(25,099)
Federal Statutory Tax Rate	35.0%	21.0%		35.0%	21.0%		35.0%	21.0%	
ADIT needed to normalize ADR Repair allowance - Proforma adjustment to test year tax expense - To RCK-2	3,174	1,792	4,966	1,311	788	2,098	4,485	2,580	7,065

Adjustment 2

SHARE Tax adjustments to be flowed through via the Tax Adjustment Clause

2019 Current Period SHARE Flow Thru Benefit	**Electric**	**Gas**	**Total**
2019 Period Estimate of SHARE tax deduction (excluding repair allowance)	(12,391)	(172,342)	(184,733)
2019 Period Estimate of ADR Repair Allowance deduction	(33,000)	(10,000)	(43,000)
2019 Period Estimated Total SHARE Deduction	(45,391)	(182,342)	(227,733)
2019 Period Estimate of book depreciation associated with SHARE property	286	1,869	2,155
2019 Period Estimate of book depreciation associated with Repair Allowance property	15,211	2,442	17,653
2019 Period Estimated Total SHARE Book Depreciation	15,496	4,311	19,807
Net flow through deduction to be included in the Tax Adjustment Clause	(29,895)	(178,031)	(207,925)

Adjustment 3 - ITC Reclass

As reflected in FERC Form 1, this adjustment pertains to the realignment of the unamortized ITC balance between Electric and Gas

	Electric	Gas	Total
Page 266, FERC Form 1 - Adjusment Column	4,725	(4,725)	-

Adjustment 4 - Operating vs Non-Operating

	Electric	Gas	Total
Full Year 2017 Adjustment Reducing Operating Income - included in December 2017 Pre-tax Income	(20,643)	-	(20,643)
Statutory Tax Rate	40.85%		40.85%
See Reply To S-OCI-PSEG-TAX-0129	(8,432)	-	(8,432)

Adjustment 5 Power Spin Off Def Gain on InterCo Trans
See Reply To OCI-Tax-0080

Adjustment 6 Elimination of IRC 199 Manufacturer's Deduction
See Reply To OCI-Tax-0142

Adjustment 7 Remove Solar 2016 Return to Accural
See Reply To OCI-Tax-0144

Adjustment 8 To Adjust For Correct Operating Income - RCK-5 Adjustment 8
See OCI-Tax-0061 - Tab Pre-tax Operating Income Adj

PUBLIC SERVICE ELECTRIC AND GAS COMPANY

ADJUSTMENT RELATED TO THE OFFSET OF STORM COSTS WITH UNPROTECTED EXCESS DEFERRED TAXES
($000's)
12+0 Update

	Electric	Gas	Total
Proforma Adjustment to Accumulated Deferred Income Tax			
Offset Deferred Storm Costs with Unprotected Excess Deferred Tax			
Unprotected Excess Deferred Tax	(226,265)	(270,623)	(496,887)
Offest Deferred Storm Costs	258,581	7,565	266,146
Offset other Regulatory Assets	2,238	10,616	12,854
			-
Offset Related Deferred Tax at 28.11%	(73,316)	(5,111)	(78,427)
Remaining Unprotected Excess Deferred Taxes	(38,762)	(257,552)	(296,315)
Percentage of Excess Deferred Tax Related to Rate base	76%	78%	
Adjustment Required to Plant Related Accumulated Deferred Income tax - To RCK-4	141,702	10,199	151,901

Public Service Electric and Gas Company
Case Name: 2018 PSE&G Rate Case
Docket No(s): ER18010029 and GR18010030

Response to Discovery Request: S-OCI-PSEG-TAX-0040
Date of Response: 5/1/2018
Witness: Krueger, Robert
Compliance ARAM IRS Requirements

Question:
Please describe and explain PSE&G's approach to verifying that its ARAM approach complies with IRS requirements and the requirements of the 2017 Federal Tax Act. Also explain PSE&G's approach to documenting its compliance. Describe and explain the steps taken to verify and document compliance. Provide all documents prepared by PSE&G to demonstrate that its ARAM approach complies with those requirements.

Attachments Provided Herewith: 0

Response:
The ARAM computation itself, while voluminous, is quite simple. PSE&G has reviewed the Power Tax methodology used in its depreciation system and concluded it mathematically comports with the basic reversal at average rate under the ARAM rules. The main uncertainties of the computation lie in which temporary differences are subject to the requirements.

PSE&G's position is to use ARAM on all temporary differences that one could make an argument it applies to. This is the best path to avoid a normalization violation as there is no penalty for using ARAM on something that is not required to reverse via ARAM. Therefore, the Company's position is that any temporary difference that is either created or reversed through tax depreciation is subject to ARAM. Also, PSE&G treats cost of removal related to assets placed in service after 1980 as protected based on the statutory language in section 168 of the Internal Revenue Code and an IRS private letter ruling. As new rulings emerge providing clarity to the definition of temporary differences subject to ARAM, PSE&G may be able to adjust its balance of protected and unprotected deferred taxes through its proposed Tax Adjustment Credit (TAC) mechanism.

Under PSE&G's approach, such corrections would not put the Company at risk of a normalization violation. If however, the Company learned through rulings or regulations of a new interpretation that would create the possibility of a normalization violation, PSE&G would follow IRS recently released guidance on how to cure an "inadvertent" normalization violation and adjust rates through the TAC mechanism to avoid any normalization penalty.

Public Service Electric and Gas Company
Case Name: 2018 PSE&G Rate Case
Docket No(s): ER18010029 and GR18010030

Response to Discovery Request: S-OCI-PSEG-TAX-0080
Date of Response: 5/16/2018
Witness: Krueger, Robert
Deferred Tax "TD - Power Spin Off Def Gain on InterCo Trans."

Question:
Referring to the response to PS-INF-0001, excel file for Krueger Workpapers, tab titled "Deferred build," Section titled "Electric Deferred Provision,"

Please describe and explain the nature of the temporary difference associated with the deferred tax provisions shown on the line titled "TD - Power Spin Off Def Gain on InterCo Trans." Explain why the provisions shown on this line are properly included in deferred income tax expense in this rate case.

Attachments Provided Herewith: 0

Response:
As background, in the year 2000, PSE&G sold its entire generation fleet to its affiliate, PSEG Power, in an arm's length, fully taxable sale. That sale produced a gain for tax purposes, but no related book gain. Typically, in a taxable assets sale, the gain on sale reverses existing deferred taxes to zero.

However in this case, the recognition of the taxable gain was deferred under the consolidated return provisions of the IRC, and is being recognized annually over the tax lives of the assets sold. As PSEG Power depreciates the related step –up in basis, gain is recognized on the utility in equal and offsetting amounts. As a result of this deferral, deferred taxes were retained on PSE&G's books equal to the future tax liability to be recognized on the deferred gain. These deferred taxes represent the basis difference between book and tax plant included in the sale. There are numerous IRS private letter rulings ("PLRs") that hold that when a utility's assets are removed from regulation (rate base), all related deferred taxes, including excess deferred taxes, must be likewise removed from the regulatory books of account. The PLRs assert that should deferred taxes and excess deferred taxes remain and either reduce rate base or pass back to customers, then a violation of the IRS normalization rules would occur (see PLRs 8920025 and 9652008 as just a few examples of such rulings). Accordingly, since the asset sale, PSE&G has excluded this item of deferred tax from regulation in all regards. Since this deferred tax liability must remain out of regulation, based on holdings in the numerous PLRs, it is clear that any excess deferred taxes cannot be returned to customers without violating the normalization rules. The Company has therefore not included the related excess deferred taxes in the regulatory liability to customers and rather let it flow through to the income statement as generally required by ASC 740. These excess deferred taxes will be flowed through income as non-operating income, since it is not jurisdictional for ratemaking purposes.

Per the above, the deferred tax associated with this item should be removed from the computation of current and deferred tax expense. The 9+3 inadvertently, included at electric a $340,930 current tax expense and offsetting deferred tax expense, thus no net impact on operating income. Also, Gas's current tax expense included a $68,346 benefit with an offsetting deferred tax expense again with no net impact on operating income. Accordingly, these items will be removed in the 12+0.

Public Service Electric and Gas Company
Case Name: 2018 PSE&G Rate Case
Docket No(s): ER18010029 and GR18010030

Response to Discovery Request: S-OCI-PSEG-TAX-0093
Date of Response: 6/19/2018
Witness: Krueger, Robert
Cost of Removal

Question:
Referring to the response to S-OCI-PSEG-TAX-0040, please explain in more detail the basis for PSE&G's determination that cost of removal related to assets placed into service after 1980 should be classified as protected. Identify and explain the specific statutory language in Section 168 applicable to that determination. Describe and provide the private letter ruling referred to in the response.

Attachments Provided Herewith: 1
S-OCI-PSEG-TAX_0093_Letter Ruling 8616018 Jan 14 1986 Norm Cost of Removal.rtf

Response:
PSE&G objects to this question on the ground that it seeks a legal interpretation and is therefore not a proper subject of discovery. Subject to and notwithstanding this objection, PSE&G responds as follows.

This is a position PSE&G has consistently applied since the adoption of Accelerated Cost Recovery System (ACRS) depreciation in 1981. To be clear however, this presently only applies to electric distribution property. Gas distribution does not accrue cost of removal as part of its depreciation rate. PSE&G believes cost of removal not included as negative salvage as a component of the depreciation rate is not subject to the normalization rules.

The Economic Recovery Tax Act of 1981 enacted ACRS, which was applicable to property placed in service after 1980. Within those rules, there was a new normalization provision described below, which has since been re-designated as IRC Section 168(i)(9).

Section 168(e)(3) of the Code provides that the term "recovery property" does not include public utility property (within the meaning of section 167(1)(3)(A)) if the taxpayer does not use a normalization method of accounting.

Further, Section 168(e)(3)(B) of the Code provides that in order to use a normalization method of accounting with respect to any public utility property the taxpayer must, in computing its tax expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, (i) use a method of depreciation with respect to such 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; and (ii) if the amount allowable as a deduction under this section with respect to such property differs from the amount that would be allowable as a deduction under section 167 (determined

IRS Letter Rulings and TAMs (1954-1997), UIL No. 168.00-00 Amortization of emergency facilities, Letter Ruling 8616018, (Jan. 14, 1986), Internal Revenue Service, (Jan. 14, 1986)

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Letter Ruling 8616018, January 14, 1986

Uniform Issue List Information:

UIL No. 0168.00-00

Amortization of emergency facilities

IRS REF: Refer Reply to:CC:C:E:E:1-5A1501 Re: Request for Ruling

This is in response to your January 7, 1985, request for ruling and subsequent submissions. You have requested a ruling under section 168(e) of the Internal Revenue Code regarding the proper treatment of the cost of removal upon the retirement of depreciable property. Specifically, you have requested a ruling that where net salvage is used to calculate regulated tax expense under section 168(e)(3)(B)(i) of the Code, net salvage value must be used under section 168(e) (3)(B)(ii) to calculate the adjustment to reserve reflecting the deferral of taxes.

P is the common parent of a group of affiliated corporations which includes S. S is a public utility which provides telecommunications services within and between local exchanges in a * * * state operating area. S also provides access to this local exchange network to long distance carriers. The charges which S makes to its customers are set by regulatory authorities.

For tax purposes, S uses:

(1) the Class Life System provided by section 1.167(a)-12 of the Income Tax Regulations for property placed in service before January 1, 1971;

(2) the Asset Depreciation Range provided by section 1.167(a)-11 of the regulations for property placed in service after December 31, 1970 and before January 1, 1981;

(3) the facts and circumstances method provided by section 1.167(a)-1 of the regulations for property placed in service before January 1, 1981 for which no elections under sections 1.167(a)-11 or 1.167(a)-12 were made; and (4) the Accelerated Cost Recovery System provided by section 168 of the Code for property placed in service after December 31, 1980.

For property placed in service after 1969, S has used accelerated methods of computing depreciation.

In computing its depreciation expense on its regulated books of account and for ratemaking purposes, S uses the straight line method of computing depreciation. S calculates this depreciation expense over the useful lives prescribed by Rl.

For property placed in service after December 31, 1980, which for tax purposes is depreciated under the Accelerated Cost Recovery System (ACRS) provided by section 168 of the Code, R1 uses net salvage value /1/ to compute depreciation expense on S's regulated books of account and R2 uses net salvage value to compute depreciation expense and tax expense when establishing S's cost of service for ratemaking purposes. Thus, an aliquot portion of the cost of removal is reflected each year in S's depreciation expense on its regulated books of account and in establishing S's cost of service for ratemaking purposes. For tax purposes, section 168 does not consider salvage value.

R2 proposes that in computing the amount to be normalized under section 168(e)(3) of the Code, gross salvage value be used in computing the amount of taxes deferred due to accelerated rates of depreciation. This would treat the cost of removal as a flow-through item.

Section 168(a)(1) of the Code provides that there shall be allowed as a deduction for any taxable year, the amount determined under this section with respect to recovery property. Section 168(e)(3) of the Code provides that the term “recovery property” does not include public utility property (within the meaning of section 167(1)(3)(A)) if the taxpayer does not use a normalization method of accounting.

Section 168(e)(3)(B) of the Code provides that in order to use a normalization method of accounting with respect to any public utility property the taxpayer must, in computing its tax expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, (i) use a method of depreciation with respect to such 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; and (ii) if the amount allowable as a deduction under this section with respect to such property differs from the amount that would be allowable as a deduction under section 167 (determined without regard to section 167(1)) using the method (including the period, first and last year convention, and salvage value) used to compute regulated tax expense under subparagraph (B)(i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

Section 168(e)(3)(C)(i) of the Code provides that the requirements of section 168(e)(3) (B) are not met if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with the requirements of section 168(e)(3)(B) . Section l68(e)(3)(C)(ii) provides that the procedures and adjustments which are to be treated as inconsistent for purposes of section 168(e)(3)(C)(i) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer’s tax expense, depreciation expense, or reserve for deferred taxes under section l68(e)(3)(B)(ii) unless such estimate or projection is also used for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.

From the foregoing, it is clear that in calculating the amount to be normalized under section 168(e)(3)(B) of the Code, a taxpayer must use the same method of calculating salvage value in computing the reserve for deferred taxes as it uses in computing its tax expense and depreciation expense for ratemaking purposes. **Thus, if S uses net salvage value to calculate its regulated tax expense and depreciation expense under section 168(e)(3)(B)(i) , S must use net salvage value under section l68(e)(3)(B)(ii) to calculate the adjustment to the reserve for deferred taxes. The use of any other method of computing salvage value for purposes of computing the adjustment to the reserve for deferred taxes violates the consistency requirement of section l68(e)(3)(C)(ii).**

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by adoption of temporary or final regulations, to the extent the regulations are inconsistent with any conclusion in the ruling. See section 17.04 of Rev. Proc. 85-1 , 1985-1 C.B. 440. However, when the criteria in section 17.05 of Rev. Proc. 85-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

Sincerely yours,

John W. Holt Director, Corporation Tax Division

FOOTNOTE

/1/ Net salvage value refers to gross salvage value less cost of removal.

Public Service Electric and Gas Company
Case Name: 2018 PSE&G Rate Case
Docket No(s): ER18010029 and GR18010030

Response to Discovery Request: S-OCI-PSEG-TAX-0129
Date of Response: 6/25/2018
Witness: Krueger, Robert
Tax Amount Differences

Question:
Referring to page 11 of Mr. Krueger's 9+3 Update Direct Testimony, please provide the following information concerning the adjustment for operating versus non-operating tax expense: (1) describe how the income tax accruals recorded on the company's books separate total income tax expense between operating and non-operating tax expense. Explain how the error described by Mr. Krueger relates to that process. Is total income tax expense calculated based on total pre-tax income, with a subsequent deduction of the non-operating value to derive operating income tax expense? Or are separate calculations made for operating and non-operating tax expense?; (2) describe and explain the reasons why the pre-tax operating income used in computing tax expense became out of sync with pre-tax operating income reported for financial statement purposes. Also explain how this impacted the split between operating and non-operating income tax expense and operating income tax expense; (3) Referring to Mr. Krueger's Schedule RCK-5 R-1, explain why the error did not impact gas distribution; and (4) provide a schedule showing the electric distribution pre-tax operating income used in the tax calculations (not including the correction recorded in December) and the pre-tax operating income that should have been used to calculate operating income tax (apparently the value reported for financial statement purposes) by month for 2017.

Attachments Provided Herewith: 0

Response:
1-2) In accordance with the Uniform System of Accounts (USofA), PSE&G is required to calculate and record regulatory tax amounts (expense or credits) related to utility operating income as well as tax amounts related to Other Income and Deductions ("non-operating" income). Operating and non-operating income items are defined within the USofA.
For GAAP accounting and reporting purposes, PSE&G is required to calculate and record tax amounts (expense or credits) related to total GAAP pre-tax income. GAAP pre-tax income is a combination of the regulatory operating and non-operating income amounts.
The starting point in the Company's process for computing regulatory income tax expense is total GAAP pre-tax income. The monthly tax closing process starts with the total GAAP pre-tax income and subtracts regulatory non-operating items in order to derive the regulatory operating and non-operating split. The error described in the filing was due to the inclusion of Electric only non-operating items related to the Company's Renewables Programs inadvertently being included in regulatory operating income. That is, these non-operating items should have been deducted from total pre-tax income but were not deducted and thus resulted in an error.

When the Company was performing a detailed review of its regulatory tax accounts in preparation of its annual FERC Form 1 filing, the error was noted and corrected. Thus, the Company's 2017 regulatory financial statements (FERC Form 1 and Annual Report to the BPU) are correctly presented. Due to the timing of the original rate case submission, the error was not corrected in the Company's original 5 + 7 submission, but was corrected via the pro forma adjustment in the 9+3 update.

3) As this issue was related only to *Electric* non-operating items related to the Company's Renewables Programs, there was zero impact to Gas distribution tax amounts.

4) For the monthly amounts that should have been used, please see the response to S-OCI-PSEG-REV-0063. For the pre-tax operating income used in the tax calculations, please see the response to S-OCI-PSEG-TAX-0061 UPDATE.

Public Service Electric and Gas Company
Case Name: 2018 PSE&G Rate Case
Docket No(s): ER18010029 and GR18010030

Response to Discovery Request: S-OCI-PSEG-TAX-0132
Date of Response: 6/25/2018
Witness: Krueger, Robert
COR Example

Question:
Referring to the responses to S-OCI-PSEG-TAX-0033 and 0079, please provide the following information regarding the treatment of the Cost of Removal temporary difference in PowerTax and its impact on ARAM calculations: (1) Describe the treatment of this item in PowerTax in prior years. Explain the split of COR between two temporary differences in more detail. Was this a vintage year split, with COR for pre-2012 plant vintages combined into a larger depreciation temporary difference and post-2011 plant vintages treated differently (i.e. with a COR removal temporary difference that was separate from the depreciation temporary difference)? Please explain what is meant by the terms “historical COR balances” and “depreciation ADIT reserve” in more detail. Explain the definition and scope (temporary differences and vintages) of those terms as used in the response; and (2) explain how the decision not to separate out the historical COR balances from the depreciation ADIT reserve made when PowerTax was implemented causes problems in the ARAM calculations. Does it result in the switch over from the current year tax rate to the composite historical tax rate to occur in the wrong year? Identify the temporary differences and plant vintages that are impacted by this problem. Provide a simplified hypothetical example using round numbers that demonstrates the problem.

Attachments Provided Herewith: 1
S-OCI-PSEG-TAX_0132_COR Example.xlsx

Response:
Please see the attached excel file “COR Example.xlsx” for additional support.

For electric distribution property, book cost of removal is accrued as a component of the book depreciation rate (as part of net salvage value). The old version (prior to 2012) of Powertax computed book depreciation on tax basis as part of its normalization computation for the “method/life” temporary difference. That accrued cost of removal remained as part of the method life temporary difference, by class and by vintage within the system (method/life would also be referred to as depreciation ADIT reserve – the cost of removal embedded therein is referred to as historical COR balance). Tax deductible cost of removal (the reversal of the COR temporary difference) was then input into related vintage and class accounts when it was incurred. So the cost of removal temporary difference was embedded as part of the method/life temporary difference. There was no separately identifiable temporary difference for cost of removal.

The new Powertax system does not compute book depreciation on tax basis. Rather, it allocates actual book depreciation between all plant related temporary differences. It creates a separately

S-OCI-PSEG-TAX-0132

2010 Vintage Asset Cost		1,000,000
Book Depreciation Rate		5%
Cost of removal Depreciation Rate		0.5%
Combined Book Rate		5.500%
Tax depreciaiton	10 year MACRS	
Cost of removal spend:		
	2011	5000
	2017	10000
	2025	15000
	2029	70000

	Total	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
		0.025	0.195	0.156	0.1248	0.0998	0.0799	0.0655	0.0655	0.0656	0.0655	0.0574									
Two Separate TD's (method/life and COR)																					
TD - 1 Tax depreciation/Method life																					
Tax Depreciation	1,000,000	25,000	195,000	156,000	124,800	99,800	79,900	65,500	65,500	65,600	65,500	57,400									
Total tax deductions	1,000,000	25,000	195,000	156,000	124,800	99,800	79,900	65,500	65,500	65,600	65,500	57,400	-	-	-	-	-	-	-	-	-
Book Depreciation	1,000,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Temporary Difference	-	(25,000)	145,000	106,000	74,800	49,800	29,900	15,500	15,500	15,600	15,500	7,400	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)
Tax Rate		35%	35%	35%	35%	35%	35%	35%	35%	21%	21%	21%	33.80%	33.80%	33.80%	33.80%	33.80%	33.80%	33.80%	33.80%	33.80%
Deferred Tax	-	(8,750)	50,750	37,100	26,180	17,430	10,465	5,425	5,425	3,276	3,255	1,554	(16,901)	(16,901)	(16,901)	(16,901)	(16,901)	(16,901)	(16,901)	(16,901)	(16,901)
ADIT	1,814,547	(8,750)	42,000	79,100	105,280	122,710	133,175	138,600	144,025	147,301	150,556	152,110	135,209	118,308	101,407	84,506	67,604	50,703	33,802	16,901	-
Excess Deferred tax - TD 1	0								57,610.00	-	-	-	(6,401.11)	(6,401.11)	(6,401.11)	(6,401.11)	(6,401.11)	(6,401.11)	(6,401.11)	(6,401.11)	(6,401.11)
TD - 2 Cost of removal																					
Tax Deduction	100,000		5,000						10,000								15,000				70,000
Book accrual	100,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000
TD - 2	-	(5,000)	-	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	5,000	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	10,000	(5,000)	(5,000)	(5,000)	65,000
Tax Rate		35%	35%	35%	35%	35%	35%	35%	35%	21%	21%	21%	21%	21%	21%	21%	26.8%	21%	21%	21%	25.5%
Deferred Tax	-	(1,750)	-	(1,750)	(1,750)	(1,750)	(1,750)	(1,750)	1,750	(1,050)	(1,050)	(1,050)	(1,050)	(1,050)	(1,050)	(1,050)	2,683	(1,050)	(1,050)	(1,050)	16,567
ADIT	(197,867)	(1,750)	(1,750)	(3,500)	(5,250)	(7,000)	(8,750)	(10,500)	(8,750)	(9,800)	(10,850)	(11,900)	(12,950)	(14,000)	(15,050)	(16,100)	(13,417)	(14,467)	(15,517)	(16,567)	-
Excess Deferred tax - TD 1	-								(3,500.00)	-	-	-	-	-	-	-	583.33	-	-	-	2,916.67
Excess Deferred tax - Combined TD		-	-	-	-	-	-	-	54,110	-	-	-	(6,401)	(6,401)	(6,401)	(6,401)	(5,818)	(6,401)	(6,401)	(6,401)	(3,484)

	Total	Prior to Conversion 2010	2011	2012	Post Conversion 2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Our situation due to conversion																					
TD - 1 Tax depreciation	1,000,000	25,000	195,000	156,000	124,800	99,800	79,900	65,500	65,500	65,600	65,500	57,400	-	-	-	-	-	-	-	-	-
Cost of Removal deduction	5,000		5,000														-				-
Total tax deductions	1,005,000	25,000	200,000	156,000	124,800	99,800	79,900	65,500	65,500	65,600	65,500	57,400	-	-	-	-	-	-	-	-	-
Book Depreciation	1,015,000	55,000	55,000	55,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Temporary Difference	(10,000)	(30,000)	145,000	101,000	74,800	49,800	29,900	15,500	15,500	15,600	15,500	7,400	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)
Tax Rate		35%	35%	35%	35%	35%	35%	35%	35%	21%	21%	21%	34.56%	34.56%	34.56%	34.56%	34.56%	34.56%	34.56%	34.56%	34.56%
Deferred Tax	(6,912)	(10,500)	50,750	35,350	26,180	17,430	10,465	5,425	5,425	3,276	3,255	1,554	(17,280)	(17,280)	(17,280)	(17,280)	(17,280)	(17,280)	(17,280)	(17,280)	(17,280)
ADIT	1,730,987	(10,500)	40,250	75,600	101,780	119,210	129,675	135,100	140,525	143,801	147,056	148,610	131,330	114,050	96,769	79,489	62,209	44,929	27,648	10,368	(6,912)
Excess Deferred tax - TD 1	(4,812)								56,210.00	-	-	-	(6,780.23)	(6,780.23)	(6,780.23)	(6,780.23)	(6,780.23)	(6,780.23)	(6,780.23)	(6,780.23)	(6,780.23)
TD - 2 Cost of removal - Tax ded	95,000	-	-	-	-	-	-	-	10,000	-	-	-	-	-	-	-	15,000	-	-	-	70,000
Book accrual	85,000				5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000
TD - 2	10,000	-	-	-	(5,000)	(5,000)	(5,000)	(5,000)	5,000	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	10,000	(5,000)	(5,000)	(5,000)	65,000
Tax Rate		35%	35%	35%	35%	35%	35%	35%	35%	21%	21%	21%	21%	21%	21%	21%	25%	21%	21%	21%	24%
Deferred Tax	2,405	-	-	-	(1,750)	(1,750)	(1,750)	(1,750)	1,750	(1,050)	(1,050)	(1,050)	(1,050)	(1,050)	(1,050)	(1,050)	2,520	(1,050)	(1,050)	(1,050)	15,635
ADIT	(133,115)	-	-	-	(1,750)	(3,500)	(5,250)	(7,000)	(5,250)	(6,300)	(7,350)	(8,400)	(9,450)	(10,500)	(11,550)	(12,600)	(10,080)	(11,130)	(12,180)	(13,230)	2,405
Excess Deferred tax - TD 1	305								(2,100.00)	-	-	-	-	-	-	-	420.00	-	-	-	1,985.45
Excess Deferred tax - Combined TD	(4,507)	-	-	-	-	-	-	-	54,110	-	-	-	(6,780)	(6,780)	(6,780)	(6,780)	(6,360)	(6,780)	(6,780)	(6,780)	(4,795)
Difference to Correct method	(4,507)	-	-	-	-	-	-	-	-	-	-	-	(379)	(379)	(379)	(379)	(542)	(379)	(379)	(379)	(1,310)

In this example, we would over amortize excess deferred taxes and net amortization would be too fast.

identifiable and tracked temporary difference for cost of removal, which the Company did not have in the old Powertax. At the time of implementation (2012), PSE&G did not have a calculation of the isolated COR temporary difference up through the date of implementation (as it was embedded within "method/life"). To avoid holding up the implementation, PSE&G began anew with respect to cost of removal. This was not a vintage year split but rather the cost of removal temporary difference that was embedded in method life remained there. Cost of removal accrued or incurred starting in 2012, was tracked separately in the Cost of Removal line in the new Powertax. So the Company has two temporary differences that cannot reverse. The balance of the cost of removal temporary difference embedded in method life cannot reverse, because PSE&G is no longer recording either accrued or incurred cost of removal into the method life temporary difference. The cost of removal temporary difference cannot reverse because its opening balance is in method life. If a temporary difference does not fully reverse, the ARAM computation will never be complete. Further, since the method/life balance and the cost of removal balance had different reversal patterns, leaving them in bifurcated as they are now will distort the ARAM computation. As the Company cannot predict with accuracy how much and to what vintage cost of removal will be incurred, the Company also cannot predict the distortion. As this problem involves the accrual of cost of removal as part of the book rate, virtually all vintages and classes of property are affected. The Company has attached a simplified example to illustrate the problem. One can see the two temporary differences fail to reverse and because of the rate change and ARAM, they fail to have offsetting balances in the end. This is a situation that must be corrected.

Public Service Electric and Gas Company
Case Name: 2018 PSE&G Rate Case
Docket No(s): ER18010029 and GR18010030

Response to Discovery Request: S-OCI-PSEG-TAX-0139
Date of Response: 7/9/2018
Witness: Krueger, Robert
Operating Vs Non-Operating Adjustment

Question:
Referring to the response to S-OCI-PSEG-TAX-0061-Update ("TAX-61"), tab titled "Summary of Monthly Data," ("the TAX-61 Schedule") and to Mr. Krueger's 9+3 Update Schedule RCK-3, R1 ("RCK-3), please provide the following information about the "Operating Vs Non-Operating Adjustment shown on the TAX-61 Schedule: (1) please explain how the adjustment was calculated. Also please explain in detail the relationship of this adjustment to the "Adjustment for Operating vs Non-Op Income - RCK 5 - Adjustment 3" shown on RCK-3. Explain why the two adjustments have different amounts. Indicate if the adjustment on the Summary of Monthly data is a replacement for the adjustment shown on RCK-3 or in addition to the adjustment shown on RCK-3; and (2) provide all calculations and workpapers supporting the "Operating Vs Non-Operating Adjustment" shown on the TAX-61 Schedule.

Attachments Provided Herewith: 0

Response:
Please refer to the response provided in S-OCI-PSEG-TAX-0129, which explains the Operating vs Non-Operating adjustment. At the time Schedule RCK-3 R1 was prepared, it was believed the adjustment impacted the entire 2017 calendar year. Under that belief, a portion of 2017 would be outside of the test period ($11.081 million) and a portion would be within the test period ($9.406 million). The adjustment in Schedule RCK-3 R1 was related to the adjustment outside the test period. Upon subsequent review it was discovered that the entire $20.487 million was recorded in December 2017. As the entire amount was recorded in December, the entire tax impact should be removed from the computation of tax expense and will be updated in the 12+0 filing. Thus in addition to the $4.526 million that is reflected as an adjustment in Schedule RCK-3 R1, the amount reflected in S-OCI-PSEG-TAX-0061-Update ("TAX-61"), tab titled "Summary of Monthly Data," ($3.843 million) should also be made. The $3.843 million equals the $9.406 million (shown below) * the 40.85% effective tax rate at the time of the adjustment.

Adjustment 4 - Operating vs Non-Operating

	Electric	Gas	Total
Full Year 2017 Adjustment Reducing Operating Income - Included in December 2017 Pre-Tax Income	(20,487)		(20,487)
Less: Portion Applicable to July 2017 - December 2017 Test Period	(9,406)		(9,406)
Portion Applicable to Jan 2017 - June 2017 Non-Test period	(11,081)	-	(11,081)
Portion Applicable to Jan 2017 - June 2017 Non-Test period - Tax Effected - to RCK -3	(4,526)	-	(4,526)

Public Service Electric and Gas Company
Case Name: 2018 PSE&G Rate Case
Docket No(s): ER18010029 and GR18010030

Response to Discovery Request: S-OCI-PSEG-TAX-0142
Date of Response: 7/6/2018
Witness: Krueger, Robert
Section 199 Solar

Question:
Referring to the response to S-OCI-PSEG-TAX-0061-Update ("TAX-61"), tabs titled "Description" and "ED Month Federal Ratecase," permanent item titled "Section 199 - Manufacturing Deduction," please: (1) explain the ratemaking treatment of the Section 199 deduction. Is this related solely to the Company's Solar program? Is the value of this tax benefit reflected in an adjustment clause separate from base rates?; and (2) explain why the Company has not proposed a rate case adjustment to eliminate the current income tax impact of this deduction since it was repealed by the 2017 TAX Act. Explain why this item should not be eliminated from the test year revenue requirements calculations as a non-recurring item.

Attachments Provided Herewith: 0

Response:
For ratemaking treatment, the Section 199 Manufacturing Deduction is a reduction to income tax expense. Yes, the associated tax benefit is related to the Company's solar program and is not reflected in an adjustment clause separate from base rates. This deduction was repealed effective January 1, 2018. Therefore, an adjustment should be made to eliminate this deduction from computation of tax expense. The adjustment will be made in the 12+0 update.

Public Service Electric and Gas Company
Case Name: 2018 PSE&G Rate Case
Docket No(s): ER18010029 and GR18010030

Response to Discovery Request: S-OCI-PSEG-TAX-0144
Date of Response: 7/12/2018
Witness: Krueger, Robert
2016 Return to Accrual

Question:
Referring to the response to S-OCI-PSEG-TAX-0061-Update (“TAX-61"), tab titled ED Month Federal Ratecase, Permanent Items, please provide the following information concerning the line titled “2016 Return to Accrual” (reference line 11): (1) explain what this line items represents. Does this adjust the 2016 book tax accrual to reflect actual amounts from the Company’s 2016 tax return filed in 2017? Explain why this item is a permanent difference. Explain why four months were impacted (as opposed to a single month). (2) Explain why the Company did not propose a rate case adjustment to eliminate the current income tax impact of this item as an out-of-period item; (3) Describe how the 2016 Return to Accrual adjustments recorded in December 2017 and January through March 2018 impacted deferred income tax expense. Were portions of the associated temporary differences normalized for BPU regulatory purposes? Identify and explain the deferred income tax provisions that were recorded; (4) provide a schedule showing the entries recorded during the test year for this item by month. Show the amounts charged/credited to current income tax expense, deferred income tax expense and accumulated deferred income taxes. Provide the deferred income tax expense amounts by month and temporary difference; and (5) explain why the GD Month FED rate case tab does not include a item for 2016 Return to Accrual. Explain why gas distribution was not impacted by the true up of the 2016 accrual to the 2016 return.

Attachments Provided Herewith: 0

Response:
The 2016 Return to accrual amount on reference line 11 for the test period represents an entry that was inadvertently recorded at Electric instead of PSE&G’s Solar Program. For the rate-case purposes, this amount should be removed from Electric. This adjustment will be made as part of the 12+0 update.

The total federal and state tax expense amount is $3,099,019. The state portion is included in the ED state ratecase tab, December, line 11- all other. This adjustment will be made as part of the 12+0 update. This amount was recorded as an increase to current tax expense, without an impact to the deferred tax expense. The amounts reflected on the “all other” line for January through March net to zero and thus do not impact the total tax expense.

Public Service Electric and Gas Company
Case Name: 2018 PSE&G Rate Case
Docket No(s): ER18010029 and GR18010030

Response to Discovery Request: S-OCI-PSEG-TAX-0154
Date of Response: 7/10/2018
Witness: Krueger, Robert
Uncertainties Protected vs. Unprotected

Question:
Referring to the attachment to the response to S-OCI-PSEG-TAX-0088 (“TAX-88"), tab titled “Descriptions,” discussion of protected deferred taxes starting on excel line 3, please identify and describe each of the “specific temporary differences the status of which (is) not entirely clear.” For each item explain the uncertainties concerning whether temporary difference should be classified as protected or as unprotected. Also identify and explain any “rulings” that PSE&G has requested, or plans to request, to clarify the proper classification of the temporary differences.

Attachments Provided Herewith: 1
S-OCI-PSEG-TAX_0154_SCE.pdf

Response:
The following list explains all protected/unprotected classifications that are not entirely certain:

Post 1981 Cost of Removal - PSE&G’s understanding is that regulatory tax treatment of cost of removal across (COR) varies across the country. While some companies have treated it as a normalized item based on an analysis similar to what PSE&G provided in S-OCI-PSEG-TAX-0093, other companies have not. Further, positions exist that even if COR is subject to normalization, the related excess deferred tax is not protected for ARAM purposes. This argument has many facets, but one potentially compelling argument is the regulatory treatment of COR typically produces a deferred tax asset and deferred tax assets should not be subject to ARAM. Southern California Edison has issued public notice that it shortly intends to file a ruling request specifically on this question. Please see the attached file “SCE.pdf”. Depending upon the outcome of this ruling, PSE&G may have to alter the way it accounts for Cost of Removal (as a separate temporary difference or as a component of the method/life difference) as well as its classification as protected or unprotected. PSE&G would propose to follow the outcome of this ruling.

Capitalized overheads including pension, OPEB, Interest, depreciation - In PSE&G’s accounting system, each such capital cost is tracked as two temporary differences – reversal of the book capitalized amount and inclusion of the tax capitalized amount. For purposes of determining the protected or unprotected status, the Company would add these two pieces together. If the net of the two figures was a deduction, PSE&G treated both pieces as unprotected, because no part of the provision or reversal of the net temporary difference involved tax depreciation. However, if the net of the two figures was an additional capitalization, then the

Company treated both pieces as unprotected, as the net temporary difference will reverse with tax depreciation. There are two uncertainties regarding this treatment.

a. The first is whether each capitalized item represents one or two discrete temporary differences that should be evaluated separately.

b. The second is, similar to the one argument regarding COR, whether a deferred tax asset can ever be protected, as it does not represent “excess deferred taxes” in a liability sense. This question was not specifically asked in the Southern California Edison’s draft COR ruling request, but it is one of the arguments used in the request. Hence, the ruling may provide insight into this issue. PSE&G has no present plans to file a ruling request on this issue as the amounts are small and its treatment is conservative in that it will not violate the normalization rules. However, PSE&G is open to filing a ruling request if the BPU deems it advisable.

Fed 2010 481a Repairs 1 & 2, Fed 2013 481a Repairs 1, Fed 481a IDD 1 & 2 - These adjustments relate to the cumulative effect of accounting method change adjustments related to the two repair accounting changes and an accounting change regarding the capitalization of indirect costs. The cumulative effect adjustment is calculated by netting the depreciation claimed on the previously capitalized costs for all years prior to the year of change against those costs for all years prior to the year of change. The net of those two amounts is the section 481(a) adjustment reflected on the tax return. PSE&G has treated the portion of the deduction related to accelerated depreciation claimed prior to the change as protected. The reason for this is because the normalization rules are very prescriptive about the ways deferred taxes may be reversed once provided in the regulatory books of account. To avoid risk of violation, PSE&G treated this portion as protected. As PSE&G’s position is conservative, the Company had no plans to seek a ruling on this topic. PSE&G is open to filing a ruling request if the BPU deems it advisable.

Fed 2012 481a O&M Recap 1-3, Fed 2007-2010 O&M Expenses – These amounts represent the capitalization of casualty loss related storm restoration costs required under the 2014 Repair Regulations. The related costs were deducted for book purposes, so capitalizing these costs for tax purposes produces a deferred tax asset. This situation is similar to COR discussed above. The issue is whether any deferred tax asset is protected under ARAM. PSE&G has treated them as protected to avoid normalization violation risk as they clearly involve tax depreciation deductions. PSE&G is open to filing a ruling request if the BPU deems it advisable.

Fed Connection Fees and Adj and CIAC – These amounts represent connection fees that are capitalized for tax purposes and treated as zero cost plant for book purposes. Again, this temporary difference represents a deferred tax asset. This situation is similar to COR discussed above. The issue is whether any deferred tax asset is protected under ARAM. PSE&G has treated them as protected to avoid normalization violation risk as they clearly involve tax depreciation deductions. PSE&G is open to filing a ruling request if the BPU deems it advisable.

All Casualty Loss adjustments and Federal Insurance Proceeds – These amounts are attributable to accelerated deductions for casualty losses caused by storm damage. The deduction is claimed under IRC section 165 and as such, PSE&G classified the amounts as unprotected. PSE&G has become aware some companies have classified this deduction as protected. The rational for such classification is that the casualty loss rules require that the depreciable basis of existing utility property be reduced by the amount of the accelerated casualty deduction. They reason that since this deduction takes the place of what would otherwise be deducted as depreciation, it falls within the protection of the normalization rules. PSE&G does not share this view, but the position is not free from doubt. This is one area where PSE&G's position is not the most conservative from a normalization perspective. PSE&G is open to filing a ruling request if the BPU deems it advisable.

SOUTHERN CALIFORNIA
EDISON®
An EDISON INTERNATIONAL® Company

Gary A. Stern, Ph.D.
Managing Director, State Regulatory Operations

June 8, 2018

ADVICE 3813-E
(U 338-E)

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
ENERGY DIVISION

SUBJECT: Copy of Request to the Internal Revenue Service Seeking Normalization Guidance Relating to Cost of Removal and the Average Rate Assumption Method

PURPOSE

As recommended by The Utility Reform Network (TURN), SCE plans to submit the attached letter seeking a Private Letter Ruling (PLR) from the Internal Revenue Service (IRS) on the computation of the Average Rate Assumption Method (ARAM) permissible under the Internal Revenue Code's normalization rules. Procedurally, SCE is following California Public Utilities Commission (Commission) Decision (D.)15-11-021, which directed SCE to submit and serve a draft of its request for a PLR prior to submitting it to the IRS. This advice letter is being submitted to provide the parties to SCE's 2018 General Rate Case (GRC) the draft PLR request.

BACKGROUND

On December 22, 2017, new Federal Income Tax Legislation was signed into law. This legislation, among other things, reduced the federal income tax rate from 35 percent to 21 percent. As a result, the deferred federal income taxes previously accrued are larger than the amounts necessary to fund the reversal of prior timing differences. This excess amount will be returned to customers.

Some component of this amount is an excess tax reserve ("protected" Excess Deferred Federal Income Taxes or EDFIT) subject to the Normalization Rules. Therefore, both utility taxpayers and their regulators must follow the ARAM prescribed by the IRS when returning these amounts to customers.

SCE's first attempt to compute ARAM for the 2018 GRC included book depreciation related to Cost of Removal (COR) in that computation. Upon further analysis, SCE removed the COR after concluding that including it would violate the Normalization

Rules. Removing the COR significantly reduced the ARAM and the revenues that would be returned to customers in 2018. TURN has recommended, and SCE agrees, that due to the magnitude of this issue and the lack of direct IRS guidance, SCE should seek clarity from the IRS on whether COR should be included in the ARAM computation. TURN further recommends SCE follow a procedural process similar to that taken in SCE's 2015 GRC. On page 452 of D.15-11-021, the Commission stated that if SCE chose to request such a ruling from the IRS, it must first submit a Tier 1 advice letter that includes a copy of its request to the IRS at least 30 days prior to sending the request to the IRS.

SCE's Private Letter Ruling Request Submission to the IRS

In the attached draft PLR request, SCE seeks the following guidance from the IRS:

1. Do the Normalization Rules apply to COR?
2. If the Normalization Rules apply to COR, should COR be treated as a discrete "protected" item or as part of the "protected" method/life difference?
3. If the Normalization Rules do not apply to COR, would those rules require that both the COR component of book depreciation accruals and future COR payments be removed from consideration in the computation of the ARAM to be applied to the "protected" EDFIT?

A copy of the ruling request to be submitted is attached as Appendix A.

No cost information is required for this advice letter.

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

TIER DESIGNATION

Similar to the procedure specified on page 452 of D.15-11-021, SCE submits this as a Tier 1 advice letter.

EFFECTIVE DATE

SCE respectfully requests that this filing become effective on June 8, 2018, which is the same date as filed.

NOTICE

Anyone wishing to protest this advice letter may do so by letter via U.S. Mail, facsimile, or electronically, any of which must be received no later than 20 days after the date of this advice letter. Protests should be submitted to:

CPUC, Energy Division
Attention: Tariff Unit
505 Van Ness Avenue
San Francisco, California 94102
E-mail: EDTariffUnit@cpuc.ca.gov

Copies should also be mailed to the attention of the Director, Energy Division, Room 4004 (same address above).

In addition, protests and all other correspondence regarding this advice letter should also be sent by letter and transmitted via facsimile or electronically to the attention of:

Gary A. Stern, Ph.D.
Managing Director, State Regulatory Operations
Southern California Edison Company
8631 Rush Street
Rosemead, California 91770
Telephone: (626) 302-9645
Facsimile: (626) 302-6396
E-mail: AdviceTariffManager@sce.com

Laura Genao
Managing Director, State Regulatory Affairs
c/o Karyn Gansecki
Southern California Edison Company
601 Van Ness Avenue, Suite 2030
San Francisco, California 94102
Facsimile: (415) 929-5544
E-mail: Karyn.Gansecki@sce.com

There are no restrictions on who may submit a protest, but the protest shall set forth specifically the grounds upon which it is based and must be received by the deadline shown above.

In accordance with General Rule 4 of GO 96-B, SCE is serving copies of this advice letter to the interested parties shown on the attached GO 96-B, A.13-11-003, and A.16-09-001 service lists. Address change requests to the GO 96-B service list should be directed by electronic mail to AdviceTariffManager@sce.com or at (626) 302-3719. 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.

Further, in accordance with Public Utilities Code Section 491, notice to the public is hereby given by submitting and keeping the advice letter at SCE's corporate headquarters. To view other SCE advice letters submitted with the Commission, log on to SCE's web site at https://www.sce.com/wps/portal/home/regulatory/advice-letters.

For questions, please contact Mark Childs at (626) 302-2397 or by electronic mail at Mark.Childs@sce.com.

Southern California Edison Company

/s/ Gary A. Stern
Gary A. Stern, Ph.D.

GAS:ds:cm
Enclosures

CALIFORNIA PUBLIC UTILITIES COMMISSION

ADVICE LETTER SUMMARY
ENERGY UTILITY

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

Company name/CPUC Utility No.: Southern California Edison Company (U 338-E)

Utility type:	Contact Person: Darrah Morgan
☑ ELC ☐ GAS	Phone #: (626) 302-2086
☐ PLC ☐ HEAT ☐ WATER	E-mail: Darrah.Morgan@sce.com
	E-mail Disposition Notice to: AdviceTariffManager@sce.com

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

Advice Letter (AL) #: 3813-E Tier Designation: 2

Subject of AL: Copy of Request to the Internal Revenue Service Seeking Normalization Guidance Relating to Cost of Removal and the Average Rate Assumption Method

Keywords (choose from CPUC listing): Compliance

AL type: ☐ Monthly ☐ Quarterly ☐ Annual ☑ One-Time ☐ Other

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

Decision 15-11-021

Does AL replace a withdrawn or rejected AL? If so, identify the prior AL:

Summarize differences between the AL and the prior withdrawn or rejected AL:

Confidential treatment requested? ☐ Yes ☑ No

If yes, specification of confidential information:
Confidential information will be made available to appropriate parties who execute a nondisclosure agreement.
Name and contact information to request nondisclosure agreement/access to confidential information:

Resolution Required? ☐ Yes ☑ No

Requested effective date: 7/8/18 No. of tariff sheets: -0-

Estimated system annual revenue effect: (%):

Estimated system average rate effect (%):

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: None

Service affected and changes proposed[1]:

Pending advice letters that revise the same tariff sheets: None

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

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

CPUC, Energy Division
Attention: Tariff Unit
505 Van Ness Avenue
San Francisco, California 94102
E-mail: EDTariffUnit@cpuc.ca.gov

Gary A. Stern, Ph.D.
Managing Director, State Regulatory Operations
Southern California Edison Company
8631 Rush Street
Rosemead, California 91770
Telephone: (626) 302-9645
Facsimile: (626) 302-6396
E-mail: AdviceTariffManager@sce.com

Laura Genao
Managing Director, State Regulatory Affairs
c/o Karyn Gansecki
Southern California Edison Company
601 Van Ness Avenue, Suite 2030
San Francisco, California 94102
Facsimile: (415) 929-5544
E-mail: Karyn.Gansecki@sce.com

Appendix A

June XX, 2018

HAND DELIVER
Associate Chief Counsel
Passthroughs & Special Industries
Courier's Desk
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 Edison Company (EIN# 95-1240335)

Dear Sir or Madam:

A ruling is respectfully requested on behalf of Southern California Edison Company (“SCE” 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(l)-1 (collectively, "Normalization Rules") to certain accounting and regulatory procedures which are described in detail hereafter.

STATEMENT OF FACTS

Taxpayer

SCE is incorporated under the laws of the State of California. Its principal place of business is located at 2244 Walnut Grove Avenue, Rosemead, California 91770, its telephone number is (626) 302-1212 and its taxpayer identification number is 95-1240335. Taxpayer employs the accrual method of accounting and reports on a calendar year basis. It is wholly-owned by Edison International ("EIX"), also a California corporation. EIX maintains its principal place of business at 2244 Walnut Grove Avenue, Rosemead, California 91770, its telephone number is (626) 302-2222 and its taxpayer identification number is 95-4137452.

SCE is included in a consolidated federal income tax return of which EIX 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 (Communications, Technology and Media Industry) of the Internal Revenue Service ("IRS" or "Service").

Taxpayer's Business

SCE is an investor-owned public utility primarily engaged in the business of supplying electricity to an approximately 50,000 square-mile area of Southern California. Taxpayer serves the approximately 14 million people in its service territory through approximately 5 million customer accounts. SCE is subject to regulation by the California Public Utilities Commission ("CPUC") and the Federal Energy Regulatory Commission ("FERC") 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 "rate of return" (*i.e.*, cost) basis.

Taxpayer's 2018 General Rate Case

Rates for California electric utilities are determined in part through general rate cases filed with the CPUC, generally, every three years. In these general rate cases, the utilities use as their base year the most recent completed calendar year and then project data for the subsequent five years. The last three of the five projected years are the years for which the rates will be effective. Taxpayer filed an application on September 1, 2016 (Application 16-09-001, hereafter referred to as the "2018 GRC") to set rates for the period 2018 through 2020. In its filing, Taxpayer used as its starting point actual data from the historic base period calendar 2015. It then projected data for 2018 through 2020. Rates in this proceeding were intended to be effective for the three-year period beginning January 1, 2018.

In computing its income tax expense element of cost of service for the 2018 GRC and for all prior rate proceedings, Taxpayer normalized the federal tax benefits attributable to accelerated tax depreciation as required by the Normalization Rules. Consequently, Taxpayer has accumulated a substantial balance of accumulated deferred income taxes ("ADFIT"). In ratemaking, Taxpayer reduces rate base by its ADFIT balance.

Shortly after the December 22, 2017 enactment of H.R. 1,[1] Taxpayer and the other participants in the 2018 GRC began developing a process for introducing the impacts of the legislation into the projection of the results for the three future test years (2018, 2019 and 2020). This process ultimately included a workshop for the parties at which time the Taxpayer filed an initial estimate of the impacts of ARAM on 2018 rates. Taxpayer then updated those estimates, based on issues with cost of removal, which this request hopes to clarify, and on February 16, 2018, the Taxpayer filed a "Tax Update" with the CPUC which included, among other things, the Company's perspective on those impacts.

Among the impacts described was quantification of the deferred federal income taxes previously provided that, as a result of the tax rate reduction enacted by H.R. 1, are no longer

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[1] P.L. 115-120.

necessary to fund the reversal of prior timing differences (Excess Deferred Federal Income Taxes or "EDFIT"). As a component of this amount, Taxpayer calculated its "excess tax reserve" ("ETR") as defined in Section 13001(d) of H.R. 1. Taxpayer also quantified the effect of applying the "average rate assumption method" ("ARAM") to that reserve. Since, by statute, the ETR consists only of deferred taxes required to be provided under the Normalization Rules (*i.e.*, the "protected" EDFIT), the ARAM is only mandatorily applicable to such deferred taxes.

One of the issues Taxpayer had to consider in computing its ETR was the treatment of cost of removal in the ETR-related calculations. This ruling request seeks guidance with respect to that treatment.

<u>Cost of Removal ("COR")</u>

The FERC Uniform System of Accounts ("USOA") prescribes the accounting rules applicable to most large investor-owned electric companies.[2] That regulation contains several definitions relevant to Taxpayer's inquiry. More specifically, the USOA defines COR as:

> …the cost of demolishing, dismantling, tearing down or otherwise removing electric plant, including the cost of transportation and handling incidental thereto. (definition 10)

"salvage value" as:

> …the amount received for property retired, less any expenses incurred in connection with the sale or in preparing the property for sale… (definition 34)

"net salvage value" as:

[2] Title 18 CFR Chapter I, Subchapter C, Part 101.

> …the salvage of property retired less the cost of removal. (definition 19)

"service value" as:

> …the difference between original cost and net salvage value of electric plant.

and "depreciation" as:

> …the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of electric plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance.

Thus, for purposes of regulatory (*i.e.*, book*)* reporting, the net positive value or net cost of disposing of an asset at the end of its life is incorporated into the annual depreciation charge. COR is, therefore, a component of establishing the applicable depreciation rate. For example, if an asset having an original cost of $1,000 has a ten-year life, has a $100 salvage value and no COR, the applicable annual depreciation rate would be 9% and the utility would recover $900 over the ten-year life of the asset. If that same asset has a $200 COR (*i.e.*, a $100 net negative salvage value), the applicable annual depreciation rate would be 11%. In Taxpayer's case, due to the material amount of COR it anticipates, in almost all instances its assets have negative net salvage values so that its book depreciation rate is higher than it would be were salvage value not considered. In effect, the annual depreciation charge creates a reserve for COR over the operating life of the asset. In the second example above, at the end of ten years, $1,100 will have been charged to depreciation, $100 more than the original cost of the asset. The $100 excess plus the $100 of salvage proceeds will fund the $200 COR incurred at the end of the asset's life.

Since book depreciation expense is included Taxpayer's cost of service used for establishing its rates, customers pay for the COR Taxpayer anticipates it will incur substantially before it actually incurs that cost. For tax purposes, COR is deductible only when actually incurred. Taxpayer, therefore, reports its customer collections that fund the COR reserve as taxable income over the operating life of an asset, claiming an offsetting tax deduction only at the end of the life of that asset. Where COR is normalized, in setting rates, customers are provided a tax benefit commensurate with their funding of COR. In other words, they are provided the COR tax benefit as they fund the COR reserve - prior to the time Taxpayer actually claims that benefit on its tax return.

The tax reserve incurred on the COR reserve funding is recorded as a deferred tax asset ("DTA"). This represents the future benefit to be derived from the eventual COR tax deduction. If COR is separately normalized (that is, separate from method/life differences), it produces a "free standing" DTA. Where it is normalized as a component of the overall book/tax depreciation differential, it reduces the net deferred tax liability ("DTL") that would otherwise have been produced (by separately treating the method/life difference).

In years prior to 2018, Taxpayer paid income tax at a 35% rate on the recovery of the COR portion of book depreciation (and provided its customers a tax benefit at that tax rate). However as a result of the tax rate reduction enacted as part of H.R. 1, Taxpayer will only receive a 21% benefit when the COR deduction is claimed. Thus, the situation is precisely the opposite from that of method/life differences where accelerated deductions produced a 35% tax benefit but, when reversed, will attract only a 21% tax.

In other words, in the case of COR, the tax rate reduction enacted as part of H.R. 1 produced a deferred tax shortfall, not an excess tax reserve. Because Taxpayer will not recover the 14% "excess" tax it paid on its recovery of the COR component of book depreciation from the government when it claims its COR deduction, it must recover it from its customers.

This Ruling Request

In calculating its ETR, Taxpayer treated COR as an item separate and distinct from method/life differences. It therefore viewed COR as having created a "free standing" DTA. Taxpayer also treated the COR DTA as unprotected – that is, it treated the DTA produced by COR as not a reserve required by the Normalization Rules. Consistent with this view, Taxpayer believes that, while the DTL produced by method/life differences is subject to the ARAM requirement, the DTA produced by COR is not and, hence, its recovery from customers is not constrained by the Normalization Rules.

Taxpayer's treatment of EDFIT attributable to COR has been questioned by The Utility Reform Network ("TURN"), a party to the 2018 GRC. TURN has proposed that Taxpayer seek a private letter ruling ("PLR") to clarify the application (or non-application) of the ARAM to COR. Taxpayer has agreed to this proposal and is filing this ruling request to seek the necessary guidance.

RULINGS REQUESTED

Taxpayer respectfully requests the following guidance:

1. *Do the Normalization Rules apply to COR?*

2. *If the Normalization Rules apply to COR, should COR be treated as a discrete "protected" item or as part of the "protected" method/life difference?*

3. *If the Normalization Rules do not apply to COR, would those rules require that both the COR component of book depreciation accruals and future COR payments be removed from consideration in the computation of the ARAM to be applied to the "protected" EDFIT?*

STATEMENT OF LAW

Code §162 allows for deductions of ordinary and necessary business expenses. Among these expenses are cost of removal.

Code §167 allows for a depreciation deduction for a reasonable allowance for exhaustion, wear and tear of property used in a trade or business.

Code §168 establishes the modified accelerated cost recovery system ("MACRS").

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

Code §168(i)(9) describes the requirements necessary to conform to a normalization method of accounting.

Code §263A(f) requires that certain interest attributable to production activities must be capitalized for tax purpose.

Treas. Reg. §1.263(a)-3(k)(1)(iii) provides that certain amounts expended to restore damage to a unit of property for which a taxpayer claimed a casualty loss must be capitalized.

Notice 87-82 (1987-2 CB 389) addressed various issues associated with the receipt of contributions in aid of construction ("CIAC"), including the associated consequences under the Normalization Rules.

In PLR 9309010 (November 30, 1992), the Service ruled that the transfer of a utility's excess tax reserve to a non-operating income account would not contravene the limitation established by section 203(e) of the Tax Reform Act of 1986 ("TRA '86").[3]

In PLR 8846003 (August 3, 1988), the Service ruled that nuclear decommissioning costs were not subject to the Normalization Rules whether or not they were included in book depreciation.

In PLR 8616018 (January 14, 1986), the Service ruled that the use of net salvage to calculate regulated tax expense while using gross salvage to compute the adjustment to a reserve required under the Normalization Rules would violate those Rules.

DISCUSSION AND ANALYSIS

Requested Ruling #1

Code §168(f)(2) provides that MACRS depreciation does not apply to any public utility property if the taxpayer fails to use a normalization method of accounting. Code §168(i)(9) describes the requirements necessary to conform to such a method. Specifically, Code §168(i)(9)(A) states that, in order to use a normalization method of accounting:

[3] P.L. 99-514.

> (ii) if the amount allowable as a deduction under this section with respect to such property (respecting all elections made by the taxpayer under this section) differs from the amount that would be allowable as a deduction under section 167 using the method (including the period, first and last year convention, and salvage value) used to compute regulated tax expense under clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

This language is significant in two regards. First, it requires an adjustment to a tax reserve to reflect "the deferral of taxes." Second, it appears to include any difference between the book method and tax method of treating salvage value as subject to the Normalization Rules.

In general, there are three requirements imposed by the Normalization Rules: (1) they mandate that the protected tax benefit (the tax benefit of accelerated depreciation) not be flowed through to customers as a reduction in the tax expense element of cost of service, (2) they limit the quantity of depreciation-related ADFIT by which rate base may be reduced and (3) for purposes of ratemaking and regulatory accounting, they limit the reduction in the ETR to the amount allowed by the ARAM. ARAM reverses the ETR at the average rate at which deferred taxes were provided as the underlying timing differences reverse.

As a threshold matter, it must be noted that this issue has repercussions that extend beyond COR. There are numerous instances in which the tax law requires all or part of the cost of particular item to be capitalized into the depreciable tax basis of an asset in excess of the amount of that item that must be capitalized for book purposes. One example is construction period interest. In general, the requirements of Code §263A(f) result in more interest being capitalized for tax purposes than for book purposes. This results in less interest being deductible for tax purposes than is expensed for book purposes.[4] This acceleration of tax will be reversed as the higher tax basis in the asset is depreciated on future tax returns. Where the book/tax difference is normalized, the tax consequences of having a higher tax basis than book basis is recorded as a DTA. The application of the Normalization Rules to capitalized interest has never to Taxpayer's knowledge been addressed by the Service. Similar situations may be presented by capitalized benefits (pension, OPEBs, etc.) where amounts capitalized under the applicable tax rules may exceed book capitalized amounts, where repairs that are expensed for book purposes must be capitalized under the casualty loss rules of Treas. Reg. §1.263(a)-3(k)(1)(iii) and other similar situations. Each of these involves an acceleration, rather than a deferral, of tax, the creation of tax basis in excess of book basis and, consequently, the recordation of a DTA.

The difference between the book and tax treatment of COR does not produce a tax deferral. On the contrary, it produces an acceleration of tax. This situation would not appear to be covered by the statutory language which refers to a "deferral of taxes." As a threshold matter, it is difficult to fathom how the purpose of the Normalization Rules – the retention of the cash produced by claiming accelerated depreciation – is served by imposing a restriction on the recovery from customers of an accelerated tax.

H.R.1's income tax rate reduction rendered some portion of all utilities' ADFIT balances "excess." The portion of this EDFIT that is attributable to ADFIT that was subject to the

[4] We will henceforth refer to the tax effect of this higher taxable income than book income as an "acceleration" (in contrast to a deferral) of tax.

Normalization Rules, the ETR, is "protected" in that it can be relieved no more rapidly than under the ARAM. Thus, the ARAM is a limitation on the flowthrough of ETR to customers. It is permissible to flow ETR through to customers less rapidly than permitted – or not at all.[5] If the ARAM applies to the DTA produced by tax-accelerating item, then, it imposes a limitation on the recovery of the deferred tax shortfall. Further, since the Service has held it permissible not to flow back any ETR at all, the "protection" of a DTA may, by analogy, suggest that it would be permissible for a regulator not to allow recovery of the tax shortfall. Again, this is counterintuitive.

Having said this, the Service has, on a few occasions, concluded or, at least, suggested that the Normalization Rules can apply to an accelerated tax.

In Notice 87-82 the Service addressed various issues associated with the change in law as part of TRA '86 which rendered CIACs taxable – also a situation which produces an acceleration, rather than a deferral, of tax.[6] One of the issues the Notice addressed was the normalization consequences of the receipt of a taxable CIAC. The Notice provides that, in general, the "negative deferral" resulting from the receipt of a taxable CIAC is subject to the Normalization Rules. No authority is cited and there is no discussion of the relevant statutory language.

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[5] See, PLR 9309010.
[6] Under the "noninclusion method" addressed by the Notice, the receipt of a CIAC is not recognized for book purposes but constitutes taxable income. The asset funded by the CIAC has no book basis and is not depreciated for book purposes but is depreciated for tax purposes.

However, having concluded that a taxable CIAC is subject to the Normalization Rules, the Notice makes an exception where the contributor is charged an additional amount to indemnify the utility for the accelerated tax. This means that a utility may not flow through in its cost of service (*i.e.*, recover from its universe of customers contemporaneously) the tax detriment produced by the accelerated tax attributable to the receipt of a CIAC but can recover that same tax detriment from the CIAC contributor. The logic of permitting the former but not the latter is not obvious. What the Service did not do was explain how the fundamental purpose of the normalization rules (the protection of the benefits of accelerated depreciation) would be compromised by permitting the flow through of the CIAC-related tax detriment in all cases.

In PLR 8616018, the Service explicitly ruled that the flow through of COR would violate the Normalization Rules.

Finally, in PLR 8846003, the Service discussed the status of nuclear decommissioning costs under the Normalization Rules. Under the situation addressed, the collection of those costs from customers preceded the taxpayer's ability to claim a tax deduction. Therefore, the taxpayer recorded a DTA for the resultant tax acceleration. Notwithstanding that the Service concluded that such costs were not subject to the Normalization Rules, its discussion indicated that "excess prepaid taxes" could be protected under the Normalization Rules and, where that was the case, that the immediate flowthrough of such taxes would violate those Rules.

The Normalization Rules apply to the benefits of accelerated depreciation – that is, deductions authorized by Code §§167 and 168. Insofar as the Normalization Rules are concerned, the conceptual difficulty in dealing with COR is that, while on the one hand it may be a component of book depreciation, it is a deduction claimed under Code §162 and has nothing to do with accelerated tax depreciation. Of the methods included in the statutory parenthetical of Code §168(i)(9)(A) (the period, first and last year convention, and salvage value), only COR represents a deduction that is not authorized by either of those Code sections.

In order to apply the Normalization Rules, the Service has, on at least one occasion, taken substantial liberties with an item having nothing to do with depreciation in order to apply those Rules. Specifically, in Notice 87-82 (referenced previously), the Service reconstructed the regulatory treatment of a CIAC for this purpose. In that Notice, the Service stated:

> For regulatory accounting purposes, utilities typically disregard the receipt of CIACs on their regulated books of account and do not include CIACs or CIAC property in income, cost of service, or rate base. This method of accounting (the "noninclusion method") is equivalent to including a CIAC in income in the year of receipt and depreciating the related CIAC property in its entirety in the same year. Accordingly, a utility using the noninclusion method of accounting for a CIAC will be treated for purposes of the normalization rules as if it computed its regulated tax expense by depreciating the related CIAC property in its entirety in the year in which the CIAC is received. The Internal Revenue Service believes that this treatment is consistent with the noninclusion method of accounting and is necessary in order to carry out the purposes of the normalization rules.

In this case the Service transmuted the regulatory disregard of the receipt of a CIAC into the receipt of income offset by depreciation of the asset in its entirety in the same year. This created book depreciation to go along with the tax depreciation available to the CIAC-funded asset in order to fit the paradigm for application of the Normalization Rules.

However, this was the recharacterization of a regulatory treatment, not a tax treatment. So far as Taxpayer is aware, the Service has never taken such liberties with tax items so as to apply the Normalization Rules to a deduction under any Code section other than §§167 or 168.

In PLR 8846003, in concluding that the DTA attributable to decommissioning was not subject to the Normalization Rules, the Service stated:

> Decommissioning costs should not be construed as being included under section 168 of the Code under any circumstance, even if the regulatory commission accounted for such costs as a component of depreciation (negative salvage value).

Code §168(i)(9)(A)'s reference to salvage value was added by Section 201 of the Economic Tax Recovery Act of 1981.[7] The Senate Committee Report[8] states:

> For this purpose, averaging conventions and salvage value limitations are considered part of the ratemaking depreciation method.[9]
>
> …
>
> The committee bill also requires that the statutory "half year" convention and salvage rules of ACRS be normalized. Therefore, if for purposes of determining the ratemaking allowance for depreciation, a salvage value limitation rule or a rule relating to first-year depreciation is used, those rules will be used in determining the amount of deferred taxes that result from using ACRS.[10]

Under ACRS, salvage value was not a factor in computing tax depreciation. This remains the case under MACRS. However, salvage value was (and remains) a factor for computing regulatory depreciation. The legislative history excerpted above twice refers to a "salvage value limitation" as the target for the normalization requirement. There are no other references to salvage value. The only limitation imposed by book salvage value conventions were (and are) that an asset may not be depreciated below net positive

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[7] P.L. 97-34.
[8] Senate Report No. 97-144, 81-2 CB 412.
[9] 81-2 CB at 429.
[10] 81-2 CB at 430.

salvage value. Net positive salvage value reduces the annual book depreciation charge. Since salvage does not affect tax depreciation, this book convention which decreases book depreciation increases the excess of tax over book depreciation. In short, it creates an additional tax deferral. Code §168(i)(9)(A) requires that this additional tax deferral be normalized. This result fits into the structure of the Normalization Rules rather comfortably. The statute does not seem to align nearly so well where net negative net salvage is concerned. It may well not have been contemplated by the drafters.

Finally, it should be noted that, although accounting for COR as a component of a utility's depreciation rate for book purposes as prescribed by the FERC USOA is the predominate practice for ratemaking as well, it is not universal. COR is, in fact, not always treated as a component of a utility's book depreciation rate in ratemaking. Section 6.05[5] of Accounting for Public Utilities[11] recognizes:

> While many consider it good ratemaking to include salvage and cost of removal in depreciation rates, considerable discretion exists regarding the extent of their inclusion. Some regulators treat salvage and cost of removal separately from depreciation rates.

In at least some jurisdictions, incurred COR amounts are amortized in arrears (*e.g.*, over the succeeding five years). It seems anomalous that COR should be subject to the Normalization Rules where it is included in the book depreciation rate but not where it is

[11] Hahne and Aliff, LexisNexis.

amortized in arrears. It is precisely the same cost in either event. The purpose of the Normalization Rules does not appear better served in the first instance than in the second.

Notwithstanding the above, in PLRs 8616018 and 8846003 the Service applied the Normalization Rules (or suggested they apply) to COR.[12]

Requested Ruling #2

While method/life depreciation differences are created and reversed solely through depreciation, such is not the case with COR. While the COR timing difference may originate as a component of book depreciation, it reverses through the incurred COR expenditure. Only if the COR deduction is deemed additional tax depreciation can it be said that COR is a pure depreciation-related timing difference. And, as indicated above, the Service has not, to Taxpayer's knowledge, recharacterized a tax expense item as depreciation for purposes of the Normalization Rules.

If the Service concludes that COR is subject to the Normalization Rules, then Taxpayer requests guidance regarding how the ETR - both the component related to the tax deferral due to method/life depreciation differences and the component related to the tax acceleration due to COR accruals (as part of book depreciation) - should be returned to ratepayers consistent with these rules. Specifically, Taxpayer seeks clarification as to whether the two components constitute a single, aggregated protected item, (the Unified Approach") which unwinds based on

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[12] Note that PLR 8616018 does not state whether the salvage value addressed was net positive or net negative.

the total book depreciation activities and COR expenditures incurred in a given year or whether, instead, they constitute two distinct protected items which reverse based on differing events (the "Disaggregated Approach").

Under the Disaggregated Approach, the ETR associated with the method/life differences (a DTL or an "excess") is flowed back as the depreciation timing differences (without considering the COR component of book depreciation) reverse while ETR associated with the COR difference (a DTA or a tax shortfall) is recovered only in the year the COR expenditure is deducted (*i.e.*, when the COR timing difference reverses). Under this method, the portion of book depreciation that represents an accrual for future COR expenditures has no impact on the ARAM calculation. Such book accruals merely generate "new" timing differences (tax accelerations) which will be tax effected at 21% and which will reverse at that same tax rate when the COR costs are actually incurred in the future.

By contrast, under the Unified Approach, the net of the method/life DTL and the COR-related DTA begins being flowed through immediately upon the reversal of the method/life difference based on total book depreciation (including the portion attributable to COR). Thus, under the Unified Approach, the aggregate ETR flows back more rapidly than it does under the Disaggregated Approach. The bottom three rows of the attached worksheet illustrates this impact.

If one of the alternatives complies with the Normalization Rules, it is at least possible that the other does not.

Requested Ruling #3

If COR is not subject to the Normalization Rules, then the recovery of its associated DTA from customers will be governed by the regulatory process and not constrained by the Normalization Rules. By contrast, the return to customers of the ETR associated with the "protected" method/life differences (a DTL) must observe the ARAM limitation.

In order to ensure compliance with the ARAM requirement, it is necessary to apply the mechanics of the Disaggregated Approach to the ETR. By this we mean that the ARAM computation must be made without regard to COR. The fraction required by the statute (total deferred taxes divided by total timing differences) must include neither the DTA nor the timing differences attributable to COR. And the amount of each year's reversing timing difference must be computed without regard to the COR component of book depreciation or any actual COR expenditures. Once the ARAM-compliant method/life flowback is determined, the DTA attributable to COR can be handled separately at the discretion of the regulators.

Absent this separate computational approach, Taxpayer does not believe it would be able to determine whether or not it is observing the ARAM requirements. The last three rows on the attached worksheet demonstrate that combining both the protected method/life and the unprotected COR flowback into a single computation (*i.e.*, the Unified Method) results in the flowback of the protected ETR more rapidly than permitted by the ARAM. In effect, the incorporation of COR into the protected flowback calculation corrupts the ARAM procedure making it, at the very least, impossible to demonstrate compliance with the statutory requirements.

TURN has specifically requested that Taxpayer seek clarification as to whether or not, for purposes of the ARAM computation, the book depreciation used to calculate the reversing timing differences must exclude COR. For the reasons stated, Taxpayer believes that it must be excluded.

CONCLUSION

For the reasons set forth above, we respectfully request the Service provide the requested guidance.

PROCEDURAL MATTERS

A. Statements required by Rev. Proc. 2018-1:

1. Section 7.01(4) –To the best of the knowledge of both Taxpayer and Taxpayer's representative, 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 the knowledge of both Taxpayer and Taxpayer's representative, 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 the knowledge of Taxpayer and Taxpayer’s representative, 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 the knowledge of Taxpayer and Taxpayer’s representative, 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 the knowledge of Taxpayer and Taxpayer’s representative, neither Taxpayer nor a related taxpayer are presently submitting additional requests involving the same or a similar issue.

6. Section 7.01(5)(e) – To the best of the knowledge of Taxpayer and Taxpayer’s representative, neither Taxpayer nor a related taxpayer had, or has, scheduled a pre-submission conference involving the same or a similar issue.

7. Section 7.01(9 and (10) – Taxpayer has included all supportive and contrary authorities of which it is aware. The law in connection with this request is uncertain and the issue is not adequately addressed by relevant authorities.

8. Section 7.01(11) - 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 James I. Warren at (202) 626-5801.

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. The Staff of the CPUC has reviewed the request and believes that the request is adequate and complete. Taxpayer will permit the CPUC to participate in any Associate office conference concerning this ruling request.

B. <u>Administrative</u>

1. The deletion statement and checklist required by Rev. Proc. 2018-1 are enclosed.

2. A Pay.gov receipt for the electronic payment of the required user fee of $28,300 is enclosed along with the appropriate application form.

3. A Form 2848 Power of Attorney granting Taxpayer's representative 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 James I. Warren at (202) 626-5959.

Respectfully submitted,

James I. Warren
Miller & Chevalier Chartered
Attorney for Southern California Edison Company

Book and Tax Basis	$ 1,000										
Book Life	10 yrs										
Tax Life	5 yrs										
COR	$ 100										
Tax Rate (yrs 1-3)	35%										
Tax Rate (yrs 4-10)	21%										
		YEAR 1	**YEAR 2**	**YEAR 3**	**YEAR 4**	**YEAR 5**	**YEAR 6**	**YEAR 7**	**YEAR 8**	**YEAR 9**	**YEA 10**
Book Dep (Life)		$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 10
Book Dep (COR)		$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 1
Total Book Dep		$ 110.00	$ 110.00	$ 110.00	$ 110.00	$ 110.00	$ 110.00	$ 110.00	$ 110.00	$ 110.00	$ 11
Tax Dep		$ 200.00	$ 200.00	$ 200.00	$ 200.00	$ 200.00	$ -	$ -	$ -	$ -	$
Tax COR		$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 10
Book over Tax (Unified)		$ (90.00)	$ (90.00)	$ (90.00)	$ (90.00)	$ (90.00)	$ 110.00	$ 110.00	$ 110.00	$ 110.00	$ 1
ADFIT (Unified)		$ (31.50)	$ (31.50)	$ (31.50)	$ (18.90)	$ (18.90)	$ 23.10	$ 23.10	$ 23.10	$ 23.10	$
ADFIT @21%		$ (18.90)	$ (18.90)	$ (18.90)	$ (18.90)	$ (18.90)	$ 23.10	$ 23.10	$ 23.10	$ 23.10	$
ETR (Unified)		$ (12.60)	$ (12.60)	$ (12.60)							
ARAM (Unified)							$ 32.34	$ 32.34	$ 32.34	$ 32.34	$
ETR Flowback (Unified)							$ 9.24	$ 9.24	$ 9.24	$ 9.24	$
Book over Tax (Life)		$ (100.00)	$ (100.00)	$ (100.00)	$ (100.00)	$ (100.00)	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 10
ADFIT (Life)		-$35.00	-$35.00	-$35.00	-$21.00	-$21.00	$21.00	$21.00	$21.00	$21.00	$21.0
ADFIT (Life) @21%		-$21.00	-$21.00	-$21.00	-$21.00	-$21.00	$21.00	$21.00	$21.00	$21.00	$21.0
ETR (Life)		-$14.00	-$14.00	-$14.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
ARAM (Life)							$29.40	$29.40	$29.40	$29.40	$29.4
EDFIT Flowback (Life)							$8.40	$8.40	$8.40	$8.40	$8.40
Book over Tax (COR)		$10.00	$10.00	$10.00	$10.00	$10.00	$10.00	$10.00	$10.00	$10.00	-$90.
ADFIT (COR)		$3.50	$3.50	$3.50	$2.10	$2.10	$2.10	$2.10	$2.10	$2.10	-$18.
ADFIT (COR) @21%		$2.10	$2.10	$2.10	$2.10	$2.10	$2.10	$2.10	$2.10	$2.10	-$18.
ETR (COR)		$1.40	$1.40	$1.40	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
ARAM (COR)											-$23.
ETR Flowback (COR)											-$4.2
Total Disaggregated ETR Flowback Life & COR							$8.40	$8.40	$8.40	$8.40	$4.20
Unified ETR Flowback							$9.24	$9.24	$9.24	$9.24	$0.84
DIFFERENCE							**-$0.84**	**-$0.84**	**-$0.84**	**-$0.84**	**$3.36**

PENALTIES OF PERJURY STATEMENT

Southern California Edison 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, correct, and complete.

Southern California Edison Company

BY:

____

DATE:________________________

PENALTIES OF PERJURY STATEMENT

Edison International

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, correct, and complete.

Edison International

BY:

____

DATE: ____________________

DELETION STATEMENT

For purposes of Section 6110(c)(1) of the Internal Revenue Code of 1986, as amended, Taxpayer requests the deletion of all names, addresses, EINs, locations, dates, amounts, regulatory bodies and other taxpayer identifying information contained in the attached request for private letter ruling.

Taxpayer reserves the right to review, prior to disclosure to the public, any information related to this request for private letter ruling and to provide redacted copies of any documents to be released to the public.

Date: ________________________ ______________________________

James I. Warren
Miller & Chevalier Chartered
Attorney for Southern California Edison Company

Public Service Electric and Gas Company
Case Name: 2018 PSE&G Rate Case
Docket No(s): ER18010029 and GR18010030

Response to Discovery Request: S-OCI-PSEG-TAX-0155
Date of Response: 7/10/2018
Witness: Krueger, Robert
MACRS Normalization Rules - Salvage

Question:
Referring to the attachment to the response to S-OCI-PSEG-TAX-0088 (“TAX-88"), tab titled “Descriptions,” temporary difference titled FED COR, please identify, provide and explain the “MACRS normalization rules” that require normalization of salvage including negative salvage if COR is included in the regulatory depreciation rate. Identify the specific provisions that require normalization of the temporary difference and explain why the rules require the electric portion of the temporary difference to be classified as protected. Also explain why the rules do not require the gas portion to be classified as protected.

Attachments Provided Herewith: 0

Response:
Please see the response to S-OCI-PSEG-TAX-0093 for related rules and a related private letter ruling “Letter Ruling 8616018 Jan 14 1986 Norm Cost of Removal.”

Regarding the difference between the treatment of electric and gas, the normalization rules speak to providing deferred taxes for the difference between tax depreciation and depreciated computed using book rates, including all conventions and salvage. Cost of removal is defined as negative salvage. PSE&G’s electric depreciation rate includes cost of removal. Since the book convention includes negative salvage, it comes within the description of what has to be normalized. PSE&G’s Gas cost of removal is not collected as a component of the book depreciation rate, but rather is a separate accrual based on a 5 year historical average of COR spend. Since Gas cost of removal is not collected through the depreciation rate, it does not fall within the description of what is required to be normalized.

Public Service Electric and Gas Company
Case Name: 2018 PSE&G Rate Case
Docket No(s): ER18010029 and GR18010030

Response to Discovery Request: S-OCI-PSEG-TAX-0156
Date of Response: 7/13/2018
Witness: Krueger, Robert
Protected and Unprotected Difference

Question:
Referring to the attachment to the response to S-OCI-PSEG-TAX-0088 ("TAX-88"), tab titled "257 Distribution Company," Jurisdiction Federal, temporary difference "DC FED COR", please : (1) explain why the entire excess deferred tax balance for this temporary difference is classified as protected (column Q). Our understanding is the temporary difference amounts shown on the 257 Distribution Company tab include both electric and gas. The Descriptions tab indicates that the FED COR temporary difference for gas is unprotected. Explain why the entire excess ADIT balance is classified as protected on the 257 Distribution Company schedule; (2) indicate if the $31.6 million excess ADIT amount shown on the 257 Distribution Company schedule (column (p), line 11) includes the $15.0 million in excess deferred ADIT reported on the 257 Gas schedule (excel column (n), line 11); and (3) explain how classifying the entire excess ADIT balance as protected on the 257 Distribution Company report impacted the electric protected and unprotected excess ADIT balances reported on tab "RCK 3 - Revised." Did classifying the entire balance as protected on the 257 Distribution Report ultimately result in the electric protected excess ADIT being overstated by $15.0 million and the unprotected balance being understated by $15.0 million? Explain why it did or did not result in an overstatement of electric excess ADIT on tab "RCK 3 - Revised."

Attachments Provided Herewith: 0

Response:

(1) This is an error; the gas portion should be treated as unprotected.

(2) The $31.6 million does include the $15.0 million for gas.

(3) The electric protected balance is overstated and the unprotected balance is understated. An updated attachment to the TAX-88 analysis can be found in the response to S-OCI-PSEG-TAX-181.

Public Service Electric and Gas Company
Case Name: 2018 PSE&G Rate Case
Docket No(s): ER18010029 and GR18010030

Response to Discovery Request: S-OCI-PSEG-TAX-0179
Date of Response: 7/12/2018
Witness: Krueger, Robert
zIncome Statement Reconciliation and Interest Synch

Question:
Referring to Mr. Jennings 9+3 Update Workpaper titled "zIncome Statement," tab titled "input," ("the zIncome Statement workpaper") and the response to S-OCI-PSEG-TAX-61, tab titled "ED Month Federal Rate Case ("TAX-61"), we recalculated the electric operating revenues and expenses shown on Mr. Jennings Schedule SSJ-16, R-1 by adjusting the amounts on the zIncome Statement workpaper for the three income tax adjustments on Mr. Krueger's Schedule RCK-3, R-1. We calculated electric monthly pre-tax operating income based on the zIncome Statement workpaper and deducted monthly electric interest from Mr. Jennings 9+3 workpaper "zInterest Sync" to derive a pre-tax income amount for use in the operating income tax calculation. The amounts were within $2 million of the amounts shown on TAX-61 for each month except December 2017, which was off $27 million. (The zInterest Sync workpaper provides monthly amounts for all necessary values except the tax deductible portion of AFUDC debt. We spread the annual amount shown on the zInterest Sync workpaper for that item to the months equally). The total difference for the test year was $19.97 million, please: (1) reconcile the monthly pre-tax operating electric amounts shown on the zIncome Statement workpaper to the electric pre-tax income used in TAX-61. Explain each reconciling item; (2) explain why the December 2017 pre-tax electric income shown on TAX-61 is significantly higher than the amount calculated based on the zIncome Statement workpaper; and (3) reconcile the monthly pre-tax operating gas amounts shown on the zIncome Tax workpaper to the monthly gas pre-tax income/loss amounts shown on the TAX-61 tab titled GD Month FED Ratecase. Explain each reconciling item.

Attachments Provided Herewith: 1
S-OCI-PSEG-TAX_0179_Tax Reconcilation.xlsx

Response:
Please see the attached Excel file "Tax Reconcilation.xlsx" for the comparison between the response to S-OCI-PSEG-TAX-61 and Mr. Jennings' workpapers.

S-OCI-PSEG-TAX-0179

ED - Op Income Per Tax Computation	July	Aug	Sept	Oct.	Nov	Dec	Jan	Feb	March	April	May	June	Total
Operating pre-tax per -Tax- 61	103,442,172	87,926,753	49,270,265	4,523,526	(1,020,340)	43,065,933	10,503,450	9,474,655	2,093,002	(784,351)	17,935,269	69,652,638	396,082,972
Operating pre-tax per zincome statement	105,306,526	88,317,334	50,934,744	6,071,144	423,699	15,512,336	11,266,379	10,373,148	382,994	(784,351)	17,935,269	69,856,655	375,595,876
Difference	(1,864,354)	(390,582)	(1,664,479)	(1,547,618)	(1,444,039)	27,553,597	(762,929)	(898,492)	1,710,008	-	-	(204,017)	20,487,095

GD - Op Income Per Tax Computation	July	Aug	Sept	Oct.	Nov	Dec	Jan	Feb	March	April	May	June	Total
Operating pre-tax per -Tax- 61	(14,162,483)	(16,401,735)	(11,688,944)	3,145,108	31,835,021	60,132,304	80,717,943	72,309,636	69,119,573	9,334,187	(7,349,477)	(11,790,983)	265,200,150
Operating pre-tax per zincome statement	(14,162,304)	(16,495,380)	(11,699,424)	3,040,960	32,031,258	60,246,628	80,703,121	72,402,230	69,227,522	9,334,187	(7,349,477)	(12,079,170)	265,200,150
Difference	(179)	93,645	10,480	104,148	(196,237)	(114,324)	14,822	(92,594)	(107,949)	-	-	288,187	(0)

The above is a monthly comparison of the operating pre-tax income reflected in income statement and Tax-0061 sheet, for electric and gas. With the exception of December, at electric, the small monthly differences are due to the timing in the closing process. To meet the closing calendar, tax generally is required to use a preliminary operating income amount. The difference between the actual vs preliminary operating income are causing the differences reflected above. The monthly small differences net to zero over the entire test period.

For electric the approximately $20.4M total ending variance relates to the incorrect classification of the solar program in December. This is discussed in S-OCI-Tax-0129.