

FLORIDA PUBLIC SERVICE COMMISSION
Capital Circle Office Center • 2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

MEMORANDUM

OCTOBER 17, 1996

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYO)

FROM: DIVISION OF WATER & WASTEWATER (JOHNSON) *ca*
DIVISION OF LEGAL SERVICES (CYRUS-WILLIAMS) *AS*

RE: DOCKET NO. [REDACTED]-SU - DISPOSITION OF CONTRIBUTION IN AID
OF CONSTRUCTION BY HUDSON UTILITIES, INC. D/B/A HUDSON
BAY COMPANY
COUNTY: PASCO

AGENDA: OCTOBER 29, 1996 - REGULAR AGENDA - PROPOSED AGENCY
ACTION - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\WAW\WP\961152.RCM

CASE BACKGROUND

As a result the repeal of Section 118(b) of the Internal Revenue Code (I.R.C.), contributions-in-aid-of-construction (CIAC) became gross income and are depreciable for federal tax purposes. In Order No. 16971, issued December 18, 1986, the Commission authorized corporate utilities to collect the gross-up on CIAC in order to meet the tax impact resulting from the inclusion of CIAC as gross income.

Order Nos. 16971, issued December 18, 1986, and 23541, issued October 1, 1990, require that utilities annually file information which would be used to determine the actual state and federal income tax liability directly attributable to the CIAC. The information would also determine whether refunds of gross-up would be appropriate. These orders require that all gross-up collections for a tax year, which are in excess of a utility's actual tax liability for the same year, should be refunded on a pro rata basis to those persons who contributed the taxes.

In Order No. 23541, the Commission required any water and wastewater utility already collecting the gross-up on CIAC and wishing to continue, to file a petition for approval with the Commission on or before October 29, 1990. Hudson is a Class B

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wastewater utility providing service to the public in Pasco County. As of December 31, 1995, the Utility served 1,172 wastewater customers. The Utility had gross operating revenues of \$629,192 for the wastewater system. The Utility reported a net operating income of \$17,394 for the wastewater system. On November 30, 1992, pursuant to Order No. 23541, Hudson Utilities, Inc. (Hudson or Utility) filed for initial authority to gross-up CIAC. The information as filed met the filing requirements of Order No. 23541. By order No. PSC-93-0206-FOF-SU, issued February 9, 1993, the Commission allowed the utility's proposed tariff to become effective by operation of law on an interim basis for gross-up on CIAC. Order No. PSC-93-0962-FOF-SU, issued June 28, 1993, granted Hudson Utilities authority to gross-up.

On September 9, 1992, this Commission issued Proposed Agency Action Order No. PSC-92-0961-FOF-WS, which clarified the provision of Orders Nos. 16971 and 23541 for the calculation of refunds of gross-up of CIAC. On October 12, 1994, Order No. PSC-94-1265-FOF-WS revised the full gross-up formula. No protests were filed, and the Order became final.

On March 29, 1996, Docket No. 960397-WS was opened to review the Commission's policy concerning the collection and refund of CIAC gross-up. Workshops were held and comments and proposals were received from the industry and other interested parties. By Order No. PSC-96-0686-FOF-WS, issued May 24, 1996, staff was directed to continue processing CIAC gross-up and refund cases pursuant to Order Nos. 16971 and 23541; however, staff was also directed to make a recommendation to the Commission concerning whether the Commission's policy regarding the collection and refund of CIAC should be changed upon staff's completion of its review of the proposals and comments offered by the workshop participants. In addition, staff was directed to consider ways to simplify the process and determine whether there were viable alternatives to the gross-up.

However, 1996, The Small Business Job Protection Act of 1996 (The Act) was signed into law by President Clinton on August 20, 1996. The Act provided for the non-taxability of CIAC collected by water and wastewater utilities effective retroactively for amounts received after June 12, 1996. As a result, on September 20, 1996, in Docket No. 960965-WS, Order No. PSC-96-1180-FOF-WS was issued to revoke the authority of utilities to collect gross-up of CIAC and to cancel the respective tariffs unless, within 30 days of the issuance of the order, affected utilities requested a variance. Since, there was no longer a need to review the Commission's policy to determine any changes and on September 16, 1996, the Commission voted to close Docket No. 960397-WS. However, as established in Order No. PSC-0686-FOF-WS, all pending CIAC gross-up refund cases are being processed pursuant to Order Nos. 16971 and 23541. The purpose of this recommendation is to address the disposition of CIAC refunds for the years 1993 and 1994.

DISCUSSION OF ISSUES

ISSUE 1: Should Hudson Utilities, Inc. be required to refund excess gross-up collections plus accrued interest for the years 1993 and 1994?

RECOMMENDATION: Yes, the utility should refund \$1,817 for 1993, and \$33,888 for 1994, for a total of \$35,705 plus accrued interest through the date of refund, for gross-up of CIAC collected in excess of the tax liability. In accordance with Orders Nos. 16971 and 23541, all refunds should be made on a pro rata basis to those persons who contributed the taxes. The refunds should be completed within six months. The utility should submit copies of cancelled checks, credits applied to monthly bills or other evidence which verifies that the refunds have been made, within 30 days from the date of refund. Within 30 days from the date of refund, the utility also should provide a list of unclaimed refunds detailing contributor and amount, and an explanation of the efforts made to make the refunds. (JOHNSON)

STAFF ANALYSIS: In compliance with Orders Nos. 16971 and 23541, Hudson filed its 1993 and 1994 annual CIAC reports regarding its collection of gross-up for each year. By correspondence dated February 29, 1996, staff submitted their preliminary refund calculation to the utility. By letter dated March 28, 1996 the utility amended its proposed refunds for 1993 and 1994 to include the costs associated with filing refund reports. The cost incurred for filing the CIAC reports was netted with the proposed refund amount. However, Orders No. 16971 and 23541 does not provide for the netting of costs incurred with filing refund reports with the excess gross-up collections. Those orders specifically require that all gross-up amounts in excess of a utility's actual tax liability should be refunded on a pro rata basis to those persons who contributed the taxes. Further, staff does not believe that the contributors should be held responsible for the accounting costs incurred to determine the amount of his refund. Staff acknowledges that these costs were incurred to satisfy regulatory requirements, but a reduction of the contributors refund amount is not the appropriate place to seek recovery of accounting charges. The utility may seek recovery of these expenses in a rate case proceeding. Therefore, staff has removed the cost for preparing the refund reports from the utility's proposed refund amount.

Staff has calculated the gross-up required to pay the tax liability resulting from the collection of taxable CIAC by

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grossing-up the net taxable CIAC amount, in accordance with the method adopted in Order No. PSC-92-0961-POP-WS.

ANNUAL GROSS-UP REFUND AMOUNTS

Based upon the foregoing, staff has calculated the amount of refund per year which is appropriate. Our calculations, taken from the information provided by the utility in its gross-up reports and tax returns filed each year are reflected on Schedule No. 1. A summary of each year's refund calculation follows.

1993

The utility proposes a refund of \$1,817 and the recovery of \$5,030 in cost for preparing the refund report in 1993. Inclusion of the refund report preparation costs in the refund calculation resulted in a revised proposed refund of \$3,212. Staff believes that a refund of \$1,817 in excess gross-up collections for 1993 is appropriate, and as previously stated, staff has excluded the accounting costs for preparing the refund report from the refund calculation.

The 1993 CIAC report indicates the utility was in a taxable position on an above-the-line basis prior to the inclusion of taxable CIAC in income; therefore, all taxable CIAC received would be taxed. The CIAC reports also indicates that a total of \$87,000 in taxable CIAC was received, with \$3,491 being deducted for the first year's depreciation. As a result, net taxable CIAC was calculated to be \$83,509. Staff has used the 37.63% combined federal and state tax rate as provided in the CIAC report to calculate the tax effect of \$50,383. The utility collected \$52,200 of gross-up monies; therefore, staff calculates that the utility collected \$1,817 more in gross-up than is required to pay the tax impact. Therefore, staff recommends that the utility be required to refund \$1,817.

1994

The utility proposes a refund of \$33,888 and the recovery of \$6,476 in cost for preparing the refund report in 1994. Inclusion of the refund report preparation costs in the refund calculation results in a revised proposed refund of \$27,412. Staff believes that a refund of \$33,888 in excess gross-up collections for 1994 is appropriate, and as previously stated, staff has excluded the costs for preparing the refund report from the refund calculation.

The 1994 CIAC report indicates the utility had an above-the-

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line loss of \$75,488 prior to the inclusion of taxable CIAC in income. As a result, all of the CIAC collected would not be taxed. Order No. 23541 requires that above-the-line losses be offset against CIAC income. Therefore, the above-the-line loss of \$75,488 must be netted with the taxable CIAC collected. The CIAC report indicates that the utility collected \$396,000 of taxable CIAC, with \$18,338 being deducted for the first year's depreciation. As a result, the amount of taxable CIAC is calculated to be \$377,662. When this amount is offset with the above-the-line loss of \$75,488, net taxable CIAC is calculated to be \$302,174. Staff has used the 37.63% combined federal and state tax rate as provided in the CIAC report to calculate the tax effect of \$182,312. The CIAC report indicates a total of \$216,200 in gross-up collections were received. Therefore, staff calculates a refund of \$33,888 for 1994. This amount does not include the accrued interest through the date of refund.

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ISSUE 2: Should the docket be closed?

RECOMMENDATION: No. Upon expiration of the protest period this docket should remain open pending verification of the refunds. Staff should be given administrative authority to close the docket upon verification that the refunds have been completed. (JOHNSON, CYRUS-WILLIAMS)

STAFF ANALYSIS: Upon expiration of the protest period, if a timely protest is not filed by a substantially affected person, this docket should remain open pending completion and verification of the refunds. Staff recommends that administrative authority be granted to staff to close the docket upon verification that the refunds have been made.

STAFF CALCULATED GROSS-UP REFUND

HUDSON UTILITIES, INC.

SOURCE: (Line references are from CIAC Reports)

	1993	1994
1 Form 1120, Line 30 (Line 15)	\$ 159,404	\$ 518,374
2 Less CIAC (Line 7)	(87,000)	(396,000)
3 Less Gross-up collected (Line 19)	(52,200)	(216,200)
4 Add First Year's Depr on CIAC (Line 8)	3,491	18,338
5 Add/Less Other Effects (Lines 20 & 21)	0	0
6		
7 Adjusted Income Before CIAC and Gross-up	\$ 23,695	\$ (75,488)
8 Taxable CIAC (Line 7)	87,000	396,000
9 Less first years depr. (Line 8)	(3,491)	(18,338)
10		
11 Taxable CIAC Resulting in a Tax Liability	\$ 83,509	\$ 302,174
12 Less: NOL Carryforward	0	0
13		
14 Net Taxable CIAC	\$ 83,509	\$ 302,174
15 Effective state and federal tax rate	37.83%	37.83%
16		
17 Net Income tax on CIAC	\$ 31,424	\$ 113,708
18 Less ITC Realized	0	0
19		
20 Net Income Tax	\$ 31,424	\$ 113,708
21 Expansion Factor for gross-up taxes	1.603334937	1.603334937
22		
23 Gross-up Required to pay tax effect	\$ 50,383	\$ 182,312
24 Less CIAC Gross-up collected (Line 19)	(52,200)	(216,200)
25		
28 (OVER) OR UNDER COLLECTION	\$ (1,817)	\$ (33,888)
27	*****	*****
28		
29 TOTAL YEARLY REFUND	\$ (1,817)	\$ (33,888)
30	*****	*****
31		
32 PROPOSED REFUND (excluding interest)	\$ (35,705)	
33	*****	