**FLORIDA PUBLIC SERVICE COMMISSION**

**Fletcher Building**

**101 East Gaines Street**

**Tallahassee, Florida 32399-0850**

**M E M O R A N D U M**

**MARCH 25, 1993**

**TO : DIRECTOR, DIVISION OF RECORDS AND REPORTING**

**FROM : DIVISION OF WATER AND WASTEWATER (MEADOR)**

**DIVISION OF LEGAL SERVICES (GOLDEN)**

**RE : UTILITY: DUVAL UTILITY COMPANY**

**DOCKET NO.: 930192-WS**

**COUNTY: CLAY COUNTY**

**CASE: DISPOSITION OF GROSS-UP FUNDS COLLECTED**

**AGENDA : APRIL 6, 1993 - CONTROVERSIAL - PROPOSED AGENCY ACTION -PARTIES MAY PARTICIPATE**

**CRITICAL DATES: NONE**

**SPECIAL INSTRUCTIONS: I:\PSC\WAW\WP\930192.RCM**

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**CASE BACKGROUND**

The repeal of Section 118(b) of the Internal Revenue Code (I.R.C.) resulted in making contributions-in-aid-of-construction (CIAC) gross income and 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.

Orders Nos. 16971 and 23541, require that utilities annually file information which would be used to determine the actual state and federal income tax expense directly attributable to the CIAC, and whether a refund of the gross-up is appropriate for any given year for which gross-up was in effect. These orders also required that all gross-up amounts for a tax year which are in excess of a utility's actual tax liability for the same year resulting from its collection of CIAC should be refunded on a pro rata basis to those persons who contributed the taxes.

In Order No. 23541, issued October 1, 1990, the Commission determined that any water and wastewater utility already collecting the gross-up on CIAC and wishing to continue collecting the gross-up, had to file a petition for approval with the Commission on or before October 29, 1990. Duval Utility Company (Duval or utility) did not request authority to continue to gross-up CIAC for the related tax impact. By Order No. 24776, issued July 8, 1991, the Commission canceled the utility's authority to gross-up.

By letter dated April 30, 1992, the utility was requested to review staff's preliminary refund calculation and provide an alternative calculation no later than May 30, 1992, if the utility disagreed with the enclosed calculation. Staff has not received any response from the utility.

By Order No. PSC-92-0961-FOF-WS, issued on September 9, 1992, the Commission clarified the procedure to be used to calculate the amount of gross-up refunds. The calculations used by staff in this recommendation are consistent with that order.

Duval is a Class C utility which provides service to water customers in Clay County. According to their 1991 annual report, operating revenues of $11,669 for water were reported. The utility reported net operating income of $2,983 for the water system.

**DISCUSSION OF ISSUES**

**ISSUE 1:** Should Duval Utility Company be required to refund excess gross-up collections plus accrued interest through the date of refund?

**RECOMMENDATION:** Yes, the utility should refund $492 for 1987; $975 for 1988; and no refund for 1989, 1990 and 1991, for a total of $1,467 plus accrued interest through the date of refund, for gross-up collected in excess of the tax liability resulting from the collection of CIAC. In accordance with Orders Nos. 16971 and 23541, all amounts should be refunded on a pro rata basis to those persons who contributed the taxes. The refund should be completed within six months. The utility should submit copies of canceled 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. If the utility has previously refunded $282 for 1987 as stated in their 1987 CIAC gross-up report, the utility should submit copies of canceled checks, credits applied to monthly bills or other evidence which verifies the refunds have been made. (MEADOR)

**STAFF ANALYSIS:** In compliance with Order No. 16971, Duval filed its 1987 through 1991 annual CIAC reports regarding its collection of gross-up for each year. Staff has a theoretical concern with the utility's calculations. This concern will be discussed below.

**COMPARISON OF ANNUAL GROSS-UP COLLECTED WITH THE TAX LIABILITY RESULTING FROM ABOVE-THE-LINE OPERATIONS**

It appears that the utility calculates the above-the-line tax liability based upon the total taxable income at its federal and state tax rates. This above-the-line tax liability is then compared to the amount of gross-up collected for the year to determine the amount of gross-up refund, if any.

Staff has several problems with this method of refund calculation. First, Orders Nos. 16971 and 23541, require that utilities annually file information which would be used to determine the actual state and federal income tax expense directly attributable to the CIAC. The utility has in fact calculated the amount of above-the-line tax liability resulting from its overall operations. With the exception of taxable CIAC, federal and state income taxes due on above-the-line operations are recovered through service rates charged to the general body of ratepayers. Therefore, if a utility has an above-the-line loss, the amount of taxable CIAC collected for the year should be netted against the above-the-line loss to determine the net amount of taxable CIAC and taxes which the gross-up was collected to pay. If a utility has above-the-line income, the total amount of CIAC collected which is taxable because of the Amendment to Section 118(b), I.R.C., should be used to calculate the tax liability.

Second, if the tax liability resulting from the collection of taxable CIAC is not looked at in isolation, the effect is that the developer or individual customer who pays gross-up is paying for the income taxes associated with the utility's overall operations, which is recoverable through service rates. Staff believes it is appropriate to use the total amount of taxable CIAC to calculate the actual tax liability attributable to the CIAC when a utility has an above-the-line taxable income and the amount of taxable CIAC should be reduced by the amount of the above-the-line loss when an above-the-line loss exists.

**ANNUAL GROSS-UP REFUND AMOUNTS**

Based upon the foregoing, staff has calculated the amount of refund per year which is appropriate. Our calculations are reflected on Schedule No. 1, attached to the recommendation. A summary of each year's refund calculation follows.

**1987**

The utility proposes a refund of $282 for 1987 excess gross-up collections. Additionally, the filing states "the company is refunding to developers $282 for the year ended 12/31/87".

Staff calculates a refund of $492 for 1987. The 1987 CIAC report indicates that a total of $2,953 of gross-up collections were received. Based upon our review of the utility's 1987 filing, the utility incurred an above-the-line income prior to inclusion of the taxable CIAC. Therefore, no reduction to the amount of taxable CIAC has been made. Staff has used the 18.40% combined federal and state tax rate as provided in the 1987 CIAC Report. Based upon the foregoing, staff calculated a refund of $492 for 1987. This amount does not include the accrued interest which must also be refunded from December 31, 1987, to the date of refund.

In the 1987 filing, the utility states "the company is refunding to developers $282 for the year ended 12/31/87". No documentation has been supplied which verifies a refund has been made. If the $282 refund has been made for 1987, the utility would need to refund an additional $210 plus accrued interest from December 31, 1987 to the date of refund, and submit evidence which verifies that the $282 refund has been made.

**1988**

The utility did not propose a refund for 1988 gross-up collections.

Staff calculated a refund of $975 for 1988. The 1988 CIAC report indicates that a total of $5,328 of gross-up collections were received. Based upon our review of the utility's 1988 filing, the utility had above-the-line loss prior to inclusion of the taxable CIAC. Staff has made a reduction to the amount of taxable CIAC. Staff has used the 18.40% combined federal and state tax rate as provided in the 1988 CIAC Report. Based upon the foregoing, staff calculated a refund of $975 for 1988. This amount does not include the accrued interest which must also be refunded from December 31, 1988, to the date of refund.

**1989 Through 1991**

The utility states no gross-up collections were made during these years and no refund is necessary. Staff agrees that no further action is necessary for any year 1989 through 1991.

The utility proposes a total refund of $282 for the years 1987 through 1991. Based upon the foregoing, staff recommends that the utility be required to refund a total of $1,467 ($492 for 1987; $975 for 1988; and no refund for 1989 through 1991), plus accrued interest through the date of refund, for gross-up collections, in excess of the actual tax liability resulting from the collection of CIAC. The refund should be completed within 6 months. The utility should submit copies of canceled checks, credits applied to monthly bills, or other evidence which verifies that the refunds have been made, within 30 days from the date of the refund. If the utility's proposed $282 refund has been made for 1987, the utility would need to refund an additional $210 for 1987 plus accrued interest from December 31, 1987 to the date of refund. If the utility has previously refunded $282 for 1987 as stated in their 1987 CIAC gross-up report, the utility should submit copies of canceled checks, credits applied to monthly bills or other evidence which verifies the refunds have been made.

**ISSUE 2:** Should the docket be closed?

**RECOMMENDATION:** Yes, the docket should be closed upon expiration of the protest period, if a timely protest is not filed. (MEADOR, GOLDEN)

**STAFF ANALYSIS:** Staff believes this docket should be closed upon expiration of the protest period, if a timely protest is not filed. Verification of the refund will be monitored by staff.

DUVAL UTILITY COMPANY STAFF CALCULATED GROSS‑UP REFUND

SOURCE: (Line references are from CIAC Reports)

1987 1988 1989 1990 1991

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1 Form 1120, Line 30 (Line 15) $ 16,528 $ 24,973 $ 0 $ 0 $ 0

2 Less CIAC (Line 7) (11,050) (22,200) 0 0 0

3 Less Gross‑up collected (Line 19) (2,953) (5,328) 0 0 0

4 Add First Year's Depr on CIAC (Line 8) 138 278 0 0 0

5 Add/Less Other Effects (Lines 20 & 21) (70) (340) 0 0 0

6 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

7 Adjusted Income Before CIAC and Gross‑up $ 2,593 $ (2,617) $ 0 $ 0 $ 0

8

9 Taxable CIAC (Line 7) $ 11,050 $ 22,200 $ 0 $ 0 $ 0

10

11 Taxable CIAC Resulting in a Tax Liability $ 11,050 $ 19,583 $ 0 $ 0 $ 0

12 Less first years depr. (Line 8) (138) (278) 0 0 0

13 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

14 Net Taxable CIAC $ 10,912 $ 19,305 $ 0 $ 0 $ 0

15 Effective state and federal tax rate 18.40% 18.40% 0.00% 0.00% 0.00%

16 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

17 Net Income tax on CIAC $ 2,008 $ 3,552 $ 0 $ 0 $ 0

18 Less ITC Realized 0 0 0 0 0

19 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

20 Net Income Tax $ 2,008 $ 3,552 $ 0 $ 0 $ 0

21 Expansion Factor for gross‑up taxes 1.225490196 1.225490196 1 1 1

22 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

23 Gross‑up Required to pay tax effect $ 2,461 $ 4,353 $ 0 $ 0 $ 0

24 Less CIAC Gross‑up collected (Line 19) (2,953) (5,328) 0 0 0

25 ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑ ‑‑‑‑‑‑‑‑‑‑‑‑

26 PROPOSED REFUND (excluding interest) $ (492) $ (975) $ 0 $ 0 $ 0

27 ============ ============ ============ ============ ============

28 No Gross‑up No Gross‑up No Gross‑up

29 TOTAL REFUND $ (1,467) Collected Collected Collected

30 ============