

## BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Request by FLORIDA WATERWORKS )	DOCKET NO. 860184-PU
ASSOCIATION for investigation of )	
proposed repeal of Section 118(b), )	ORDER NO. 21266
Internal Revenue Code (Contributions- )	
in-aid-of-Construction) )	ISSUED: 5-22-89

The following Commissioners participated in the disposition of this matter:

MICHAEL McK. WILSON, CHAIRMAN  
 THOMAS M. BEARD  
 BETTY EASLEY  
 GERALD L. GUNTER  
 JOHN T. HERNDON

NOTICE OF PROPOSED AGENCY ACTION

ORDER ESTABLISHING GUIDELINES  
REGARDING COLLECTION OF TAXES  
ON CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION

BY THE COMMISSION:

NOTICE IS HEREBY GIVEN by the Florida Public Service Commission that the actions discussed herein are preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding pursuant to Rule 25-22.029, Florida Administrative Code.

BACKGROUND

On February 13, 1986, the Florida Waterworks Association requested that we investigate a proposed repeal of Section 118(b), Internal Revenue Code, under which certain contributions to the capital of a corporation were excluded from gross income. Section 118(b), Internal Revenue Code, was, ultimately, repealed by the Federal Tax Reform Act of 1986 (Act) and, effective January 1, 1987, contributions-in-aid-of-construction (CIAC) became includable in a utility's gross income. Also under the Act, contributed assets became depreciable for federal tax purposes.

Prior to the effectiveness of the Act, the general perception by the water and sewer industry was that the inclusion of CIAC in gross income would cause certain utilities to experience cash flow problems. Therefore, on December 18, 1986, we issued Order No. 16971 on an emergency basis to allow corporate water and sewer utilities to elect whether to "gross-up" CIAC in order to meet the tax impact. Thus far, only forty-four water and/or sewer utilities have elected to gross-up. No electric utilities have elected to gross-up, although several gas utilities have expressed an interest in the gross-up. The repeal of Section 118(b) did not affect telecommunications utilities.

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Since Order No. 16971 was issued on an expedited, emergency basis, we instructed the staff of this Commission to continue to investigate the necessity and appropriateness of the gross-up.

#### CIAC AS GROSS INCOME

CIAC can be in the form of property or cash. Generally, property CIAC includes water distribution and sewage collection systems which are donated to a utility. Property CIAC is usually donated by developers and it is assumed that these costs are either included in the purchase price of a lot or home, expensed on the developer's tax return, or both. Either way, these costs are ultimately borne by the home buyer. Cash CIAC is generally collected to reimburse investment in existing plant or to defray the costs of present or future plant expansion. Although it is not uncommon for developers to make cash contributions, cash CIAC is typically collected from individual customers.

#### Collection of CIAC Without Gross-up

The inclusion of CIAC in a utility's gross income may have a severe impact on a utility's tax liability during the year of collection, which, if the utility does not also collect the taxes on the CIAC, may result in a cash flow problem. This is especially true if the CIAC collected is property, since with cash CIAC, the utility could at least use some of the cash collected to meet the tax liability. However, since contributed property is now depreciable, the utility will rarely experience any actual increase in taxes over the long run. The cash flow problem results because the full tax liability occurs in the year in which the contribution is received and is recovered over the life of the asset through depreciation.

#### Collection of CIAC With Gross-Up

If, in addition to CIAC, a utility collects the taxes on that CIAC, it will subject itself to a real increase in its tax liability or decrease in its tax loss. This occurs because contributed taxes become gross income and are, therefore, subject to being taxed. In addition, the amount of the grossed-up CIAC charge may be enough to place a utility at a competitive disadvantage with utilities which do not gross-up. A developer may, therefore, choose to either connect to a utility which does not gross-up or find some other way to avoid the gross-up, such as installing septic tanks, in order to save itself a considerable amount of money. In addition, as with CIAC, it is reasonable to assume that, regardless of the immediate source of the CIAC and the taxes, the costs will ultimately be borne by the home buyer. Adding the gross-up to the cost of a home may be enough to discourage an individual purchaser.

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#### RETENTION OF OPTIONAL GROSS-UP

In spite of the problems associated with the gross-up, we find it appropriate to retain the gross-up as a limited option. In addition, we find it appropriate to require any utility that wishes to gross-up, whether or not it is currently authorized to gross-up, to file a request for authority to gross-up. Each such request shall demonstrate the existence of an actual tax liability resulting from the utility's collection of CIAC. In addition, each such request shall demonstrate that the utility's existing cash flow is inadequate to meet the tax liability resulting from its collection of CIAC. Finally, each such request should include a statement of gross-up alternatives considered and a certification that the gross-up is the most cost effective alternative, a calculation of interest coverage both with and without utilizing the gross-up ((net income + current gross interest + total taxes - allowance for funds used during construction)/current gross interest) and revised tariff pages.

#### AMOUNT OF GROSS-UP

If a utility meets the criteria described above to qualify for the gross-up, we believe that it is reasonable to assume that the utility would find it difficult to cover even a portion of its CIAC tax liability. Accordingly, we find it appropriate to retain the full gross-up formula in all such cases, in order to allow the utility to remain whole. For utilities that have not previously had an approved gross-up, the optional gross-up shall be effective for CIAC collected on or after the stamped approval date on the gross-up tariff pages. The tariff pages will be approved upon verification that the utility qualifies for the gross-up as specified in this Order. Any utility that currently has the gross-up in place may continue to collect the gross-up, pending their filing and our approval of a request for the gross-up, as described above, which shall include revised tariff pages. The revised gross-up tariff pages will be approved upon verification that the utility qualifies for the gross-up as specified in this Order.

Prior to its implementation of the gross-up, each utility shall submit a proposed escrow agreement for this Commission's approval. The gross-up amounts shall be placed in an interest bearing escrow account, subject to refund, pending a true-up in the year following collection.

In consideration of the foregoing, it is

ORDERED by the Florida Public Service Commission that the provisions of this Order are issued as proposed agency action and will become final unless an appropriate petition is filed with the Director, Division of Records and Reporting, 101 East Gaines Street, Tallahassee, Florida 32300-0850, by the close of business on June 12, 1989. It is further

ORDERED that the optional gross-up of CIAC shall be retained, subject to certain modifications, as set forth in the body of this Order. It is further

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ORDERED that each utility that wishes to utilize the gross-up, whether or not it is currently authorized to gross-up, shall file a request for authority to gross-up no later than sixty (60) days following the effective date of this Order. It is further

ORDERED that each request to gross-up shall include the information set forth in the body of this Order. It is further

ORDERED that all collections of CIAC gross-up amounts shall be placed in a Commission approved escrow account held subject to refund, with interest, in accordance with Rule 25-30.360, Florida Administrative Code. It is further

ORDERED that, prior to any utility's implementation of the gross-up, it shall submit a proposed escrow agreement and either original or revised gross-up tariff pages. The tariff pages shall be approved upon verification that the utility qualifies for the gross-up as set forth in the body of this Order. It is further

ORDERED that, after June 12, 1989, this Commission will issue either an order indicating that the provisions of this Order have become final or a notice of further proceedings.

By ORDER of the Florida Public Service Commission  
this 22nd day of MAY, 1989.

  
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STEVE TRIBBLE, Director  
DIVISION OF RECORDS AND REPORTING

( S E A L )

RJP

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida

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Administrative Code. This petition must be received by the Director, Division of Records and Reporting at his office at 101 East Gaines Street, Tallahassee, Florida 32399-0870, by the close of business on June 12, 1989. In the absence of such a petition, this order shall become effective June 13, 1989 as provided by Rule 25-22.029(6), Florida Administrative Code, and as reflected in a subsequent order.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this order becomes final and effective on June 13, 1989, any party adversely affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.