

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Disposition of) DOCKET NO. 920465-WS
contributions-in-aid-of-) ORDER NO. PSC-92-0960-FOF-WS
construction (CIAC) gross-up) ISSUED: 09/09/92
funds received by SUNRAY)
UTILITIES - NASSAU, INC. in)
Nassau County)
_____)

The following Commissioners participated in the disposition of this matter:

THOMAS M. BEARD, Chairman
SUSAN F. CLARK
J. TERRY DEASON
BETTY EASLEY
LUIS J. LAUREDO

NOTICE OF PROPOSED AGENCY ACTION

ORDER APPROVING REFUND OF GROSS-UP ON
CONTRIBUTIONS-IN-AID-OF-CONSTRUCTION

BY THE COMMISSION:

BACKGROUND

NOTICE IS HEREBY GIVEN by the Florida Public Service Commission that the action discussed herein is 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.

The repeal of Section 118(b) of the Internal Revenue Code (I.R.C.) resulted in making the dollar value of contributions-in-aid-of-construction (CIAC) gross income and the related assets 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 to meet the tax impact resulting from the inclusion of CIAC as gross income.

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. Sunray Utilities - Nassau, Inc. (Sunray or Utility) requested and was granted authority to continue to

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gross-up CIAC for the related tax impact by Order No. PSC-92-0130-FOF-WS, issued March 31, 1992.

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 require 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.

Sunray is a Class C utility which provides water and wastewater service to 65 water customers and 64 wastewater customers in Nassau County. In its 1991 annual report, operating revenues of \$9,587 for water and \$11,246 for the wastewater system were reported. The utility reported a net operating loss of \$76,065 for the water system and \$132,662 for the wastewater system.

In compliance with Order No. 16971, Sunray filed its 1988 through 1990 annual CIAC reports regarding its collection of gross-up for each year. Each area of concern will be addressed separately.

TEST YEAR USED AND USEFUL PERCENTAGES

The utility employed a 57.90% used and useful percentage in its determination of above-the-line amounts. In November, 1988, Sunray began providing service to 17 connected customers. Sunray had plant capacity available to serve 429 water and 534 wastewater customers. This would result in used and useful percentages of approximately 4%. The utility stated that rather than charging such a low percentage of depreciation, interest, and non-variable operating costs to above-the-line income, Sunray used the 57.90% used and useful percentage calculated in Order No. 20252, issued November 3, 1988.

Order No. 20252 clearly states on page 4 that the rate base, capital structure, and operating statements are presented only as a tool used in establishing initial rates. They are not intended to establish rate base. We believe that the basis of allocation of expenses to above and below-the-line operations should be the actual used and useful percentages for each specific year. When actual percentages are not available, estimated used and useful percentages for each specific year should be used.

For determination of the amount of any above-the-line loss to be used to reduce test year taxable CIAC collections, the 4% used and useful percentages should be employed in this case. This more accurately allocates actual expenses to above-the-line operations than the use of the projected used and useful percentage at 80% of designed capacity, which is projected to occur in 1997 for the water system and 1995 for the wastewater system.

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

As a part of the utility's 1990 CIAC report, the utility provided its proposed refund calculations. The utility stated that the jurisdictional amounts reflected in the 1988 CIAC Report were based on the 57.90% used and useful percentages. The utility then calculated the above-the-line tax liability based on the allocated expenses. This above-the-line tax liability was then compared to the amount of gross-up collected for the year to determine the amount of gross-up refund, if any.

We have 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 tax liability resulting from its above-the-line 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 that 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. 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.

EXPANSION OF THE NET INCOME TAX RESULTING
FROM COLLECTION OF CIAC FOR GROSS-UP TAXES

The utility has raised the issue of whether the taxes paid on the amount of gross-up collected should be included in the calculation of the refund. The utility proposes to include the full amount of gross-up with the taxable CIAC in order to calculate the net income tax due. This calculates the tax liability on the taxable CIAC and the full taxes on all gross-up collected. This results in an overstatement of the tax liability.

Only the taxes on the amount of gross-up to be retained by the utility should be included in the refund calculation and not the total amount of taxes on the amount of gross-up collected. The gross-up collections that are refunded reduce taxable revenue and are no longer taxable to the utility. Therefore, no taxes are due. In accordance with Orders Nos. 16971 and 23541, we calculated the amount of taxes that resulted from the collection of taxable CIAC (Line 13, Schedule No. 1). This amount represents the amount of gross-up the utility will need to pay the taxes. However, this amount has not been expanded for inclusion of the income taxes. Therefore, to make this amount comparable with the gross-up collections, we expanded the amount of taxes resulting from the collection of CIAC and calculated the "gross-up required" (Lines 13 through 16, Schedule No. 1). The gross-up required amount is then compared to the gross-up collected to determine the amount of refund, if any.

ANNUAL GROSS-UP REFUND AMOUNTS

Based on the foregoing, we have calculated the appropriate amounts of refunds per year. Our calculations are reflected in Schedule No. 1. A summary of each year's refund calculation follows.

1988 - In its revised calculations, the utility proposed a refund of \$18,950 plus accrued interest for 1988 gross-up collections. However, our calculations indicate that the appropriate amount of refund for 1988 is \$32,243. The 1988 CIAC report indicates that a total of \$114,480.60 of gross-up collections were received from one developer, Otter Run Partnership. Based on the revised used and useful percentage of 4%, we calculated the above-the-line loss to be \$15,747. This results in a reduction to the amount of taxable CIAC. The 27.7% combined federal and state tax rate as provided in the 1988 CIAC Report was used instead of the current combined rate of 37.63% detailed in the utility's May 12, 1992 letter. The 27.7% combined

federal and state tax rate was the rate used during the year of the CIAC collections. Therefore, based on the foregoing, we have calculated a refund of \$32,243 for 1988. This amount does not include the accrued interest, which also must be refunded from December 31, 1988 to the date of refund.

1989 - In its revised calculations, the utility did not propose a refund for 1989. We agree that no refund or further action for 1989 is appropriate. The 1989 CIAC report indicates that a total of \$17,489.34 of gross-up collections were received. Based on the revised used and useful percentage of 4%, we have calculated the above-the-line taxable loss to be \$15,148. This results in a reduction to the amount of taxable CIAC. The 37.63% combined federal and state tax rate was used. Based on the foregoing, we find that the tax liability exceeded the gross-up collected for the year. Therefore, no refund or further action for 1989 is appropriate.

1990 - In its revised calculations, the utility proposed to refund total gross-up collections of \$5,756 plus accrued interest for 1990. The utility stated that based on the 57.90% used and useful, the taxable above-the-line loss exceeded the amount of CIAC and gross-up collected; therefore, the utility asserts, all gross-up amounts collected should be refunded to the contributor.

We find that the appropriate refund for 1990 is \$5,756. The 1990 CIAC report indicated that a total of \$5,756.40 of gross-up collections were received. Based on the revised used and useful percentage of 4%, we calculated an above-the-line loss of \$68,267. There should be a reduction to the amount of taxable CIAC for the loss and for the first year's depreciation. The 37.63% combined federal and state tax rate was used. There is no resulting income tax for 1990. Therefore, based on the foregoing, we find that the full amount of gross-up collections of \$5,756 for 1990 shall be refunded. This amount does not include the accrued interest, which also must be refunded from December 31, 1990 to the date of refund.

Based on the foregoing, we find that no further action is required for 1989, the utility shall refund \$32,243 for 1988, and \$5,756 for 1990, 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. In accordance with Orders Nos. 16971 and 23541, all amounts shall be refunded on a pro rata basis to those persons who contributed the taxes. The refund shall be completed within six months of the effective date of this Order. The utility shall file copies of the canceled refund checks, credits applied to monthly bills, or other evidence that verifies

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that the refunds have been made, within 30 days from the date of the refund.

Based on the foregoing, it is, therefore,

ORDERED by the Florida Public Service Commission that Sunray Utilities - Nassau, Inc. is hereby ordered to refund \$32,243 for 1988 and \$5,756 for 1990, plus accrued interest through the date of refund, on a pro rata basis to contributors. No refund shall be required for 1989. It is further

ORDERED that the provisions of this Order are issued as proposed agency action and will become final unless a person whose interests are adversely affected files a petition for a formal proceeding pursuant to Rule 25-22.029, Florida Administrative Code. It is further

ORDERED that the refund shall be completed within six months of the effective date of this Order. It is further

ORDERED that Sunray Utilities - Nassau, Inc. shall file copies of the canceled refund checks, copies of credits applied to monthly bills, or other evidence for verification within 30 days of the completion of the refund. It is further

ORDERED that, in the event no timely protest is received and upon verification that the refunds have been made, this docket shall be closed.

By ORDER of the Florida Public Service Commission this 9th day of September, 1992.

(S E A L)

STEVE TRIBBLE, Director
Division of Records and Reporting

KAC

by: Kay Flynn
Chief, Bureau of Records

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 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 September 30, 1992.

In the absence of such a petition, this order shall become effective on the day subsequent to the above date as provided by Rule 25-22.029(6), Florida Administrative Code.

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 the date described above, 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 wastewater 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.

SUNRAY UTILITIES - NASSAU, INC.
 SOURCE: (Line references are from CIAC Reports)

CALCULATED GROSS-UP REFUND

	1987	1988	1989	1990
1 Taxable CIAC (Line 7)	\$ 0	\$ 220,054	\$ 110,643	\$ 8,266
2 Less Above-the-line loss (Line 15)	0	0	0	(68,267)
3				
4	\$ 0	\$ 220,054	\$ 110,643	\$ (60,001)
5 Less first years depr. (Line 8)	0	(5,406)	(6,132)	(305)
6				
7 Net Taxable CIAC	\$ 0	\$ 214,648	\$ 104,511	\$ (60,306)
8 Effective state and federal tax rate	43.30%	27.70%	37.63%	37.63%
9				
10 Net Income tax on CIAC	\$ 0	\$ 59,458	\$ 39,327	\$ (22,693)
11 Less ITC Realized	0	0	0	0
12				
13 Net Income Tax	\$ 0	\$ 59,458	\$ 39,327	\$ (22,693)
14 Expansion Factor for gross-up taxes	1.763668430	1.383125864	1.603334936	1.603334936
15				
16 Gross-up Required to pay tax effect	\$ 0	\$ 82,238	\$ 63,054	\$ (36,384)
17 Less CIAC Gross-up collected (Line 19)	0	(114,481)	(17,489)	(5,756)
18				
19 PROPOSED REFUND (excluding interest)	\$ 0	\$ (32,243)	\$ 0	\$ (5,756)
20				
21				
22 TOTAL REFUND	\$ (37,999)			
23				

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